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# **COMMUNITY REINVESTMENT ACT**

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## **HEARINGS BEFORE THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE ONE HUNDREDTH CONGRESS**

**SECOND SESSION**

**ON**

**IF FEDERALLY OR INSURED LENDERS HAVE FULFILLED THEIR AFFIRM-  
ATIVE OBLIGATIONS TO MAKE LOANS IN THEIR COMMUNITIES AND  
IF THE FEDERAL REGULATIONS MET THEIR LEGAL RESPONSIBILITIES**

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**MARCH 22 AND 23, 1988**

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Printed for the use of the Committee on Banking, Housing, and Urban Affairs



5241-22



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## COMMUNITY REINVESTMENT ACT

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TUESDAY, MARCH 22, 1988

U.S. SENATE,  
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,  
*Washington, DC.*

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Dixon, Graham, and Garn.

### OPENING REMARKS OF SENATOR DIXON

Senator DIXON. Ladies and gentlemen, if I may have your attention, please, the distinguished chairman of the Banking Committee, Senator Proxmire, is on the floor making a very brief statement and will be in the room momentarily.

In his absence, I have been asked to open the committee hearing this morning. I'm going to indulge myself by taking this opportunity to make a very brief statement and then I'm going to place in the record a statement by the distinguished Senator from Pennsylvania, Senator Heinz. Then, if the Chairman has not yet arrived, he will be here only momentarily after that, and I will temporarily recess the committee hearing until such time as he arrives and I have to go to the floor to make a statement concerning our oversight hearings on the securities industry and the stock market experience of last October 19.

Ladies and gentlemen, I am pleased to be here this morning as the Senate Banking Committee begins 2 days of oversight hearings on the Community Reinvestment Act.

We have a good group of witnesses before us today and I look forward to their testimony. I particularly want to direct the committee's attention to three witnesses from Illinois: Gale Cincotta, the president of the National Training and Institute Center; Elspeth Revere of the Woodstock Institute; and Richard Hartnack, senior vice president of the First National Bank of Chicago.

I believe it's very appropriate for this committee to examine how the Community Reinvestment Act has worked. I strongly support the act's objectives. I think it's important to ensure that the low and moderate income neighborhoods have access to the kind of capital they need.

Redlining was and is wrong and it's based on a fundamentally mistaken assumption that lending is too risky in these areas and cannot be made profitably.

In my view, we cannot afford to write off whole areas of any city. That practice hurts us all in the long run. I'm aware that there's

evidence that indicates that disinvestment is still occurring in cities, although at least somewhat more slowly than in the past.

I'm also aware that there are real questions as to how the banking regulators have administered the act.

I appreciate the opportunity to work with all of this morning's witnesses and with other interested parties in an effort to see that the Community Reinvestment Act lives up to its promises.

Ladies and gentlemen, I'm further going to place in the record a statement from Senator Heinz of Pennsylvania, and if you will excuse me, I need to go to the floor, but I assure you that the chairman will be here momentarily. He is completing his statement even now on the floor and if you will be patient he will be here any minute now. This committee hearing will stand in recess for a few minutes until the chairman arrives.

[The complete statements of Senators Dixon and Heinz follow:]

MARCH 22, 1988

STATEMENT OF SENATOR ALAN DIXON

SENATE BANKING COMMITTEE OVERSIGHT HEARING  
ON  
THE COMMUNITY REINVESTMENT ACT

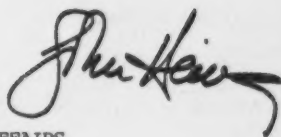
MR. CHAIRMAN, I AM PLEASED TO BE HERE THIS MORNING AS THE SENATE BANKING COMMITTEE BEGINS TWO DAYS OF OVERSIGHT HEARINGS ON THE COMMUNITY REINVESTMENT ACT. WE HAVE A GOOD GROUP OF WITNESSES BEFORE THE COMMITTEE TODAY, AND I LOOK FORWARD TO THEIR TESTIMONY. I PARTICULARLY WANT TO DIRECT THE COMMITTEE'S ATTENTION TO THREE WITNESSES FROM ILLINOIS: GALE CINCOTTA, THE PRESIDENT OF THE NATIONAL TRAINING AND INSTITUTE CENTER, ELSPETH REVERE OF THE WOODSTOCK INSTITUTE, AND RICHARD HARTNACK, SENIOR VICE PRESIDENT OF THE FIRST NATIONAL BANK OF CHICAGO.

I BELIEVE IT IS VERY APPROPRIATE FOR THIS COMMITTEE TO EXAMINE HOW THE COMMUNITY REINVESTMENT ACT HAS WORKED. I STRONGLY SUPPORT THE ACT'S OBJECTIVES -- I THINK IT IS IMPORTANT TO ENSURE THAT LOW AND MODERATE-INCOME NEIGHBORHOODS HAVE ACCESS TO THE KIND OF CAPITAL THEY NEED. REDLINING WAS AND IS WRONG, AND IT IS BASED ON A FUNDAMENTALLY MISTAKEN ASSUMPTION -- THAT LENDING IS TOO RISKY IN THESE AREAS AND CANNOT BE MADE PROFITABLE.

IN MY VIEW, WE CANNOT AFFORD TO WRITE OFF WHOLE AREAS OF ANY CITY. THAT PRACTICE HURTS US ALL IN THE LONG RUN. I AM AWARE THAT THERE IS EVIDENCE THAT INDICATES THAT DISINVESTMENT IS STILL OCCURRING IN CITIES, ALTHOUGH AT LEAST SOMEWHAT MORE SLOWLY IN THE PAST. I AM ALSO AWARE THAT THERE ARE REAL QUESTIONS AS TO HOW THE BANKING REGULATORS HAVE ADMINISTERED THE ACT.

I APPRECIATE THE OPPORTUNITY TO WORK WITH ALL OF THIS MORNING'S WITNESSES, AND WITH OTHER INTERESTED PARTY IN AN EFFORT TO SEE THAT THE COMMUNITY REINVESTMENT ACT LIVES UP TO ITS PROMISE.





STATEMENT OF THE HONORABLE JOHN HEINZ  
BEFORE THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
ON THE COMMUNITY REINVESTMENT ACT  
MARCH 22, 1988

I COMMEND YOU MR. CHAIRMAN FOR HOLDING THESE OVERSIGHT HEARINGS ON THE COMMUNITY REINVESTMENT ACT. AS THE DRIVING FORCE BEHIND PASSAGE OF THIS LANDMARK LEGISLATION IN 1977, YOU HAVE MAINTAINED AN ONGOING INTEREST IN THE PROGRESS AND EFFECTIVENESS OF THE CRA.

THE CRA WAS ENACTED IN RESPONSE TO CONGRESS' LEGITIMATE CONCERN ABOUT ALLEGED PRACTICES OF REDLINING AND ITS CONTRIBUTION TO URBAN AMERICA'S DETERIORATION. IT WAS BASED ON THE PREMISE THAT BANK CHARTERS CONFER NUMEROUS ECONOMIC BENEFITS. IN RETURN, PUBLIC POLICY RIGHTLY EXPECTS PUBLIC BENEFITS SUCH AS FINANCIAL INSTITUTIONS MEETING THE CREDIT NEEDS OF THEIR LOCAL COMMUNITIES.

SINCE ITS ENACTMENT, QUESTIONS HAVE BEEN RAISED AS TO THE REGULATORS' COMMITMENT TO ENFORCEMENT OF THE CRA AS WELL AS THE CRA'S SUCCESS RATE IN ELIMINATING EVEN THE MOST OBVIOUS REDLINING PRACTICES, INCLUDING FINANCIAL INSTITUTIONS' REFUSAL TO ACCEPT LOAN APPLICATIONS WITHIN A DESIGNATED AREA, REFUSAL TO MAKE LOANS SECURED BY PROPERTY WITH A DESIGNATED AREA, REFUSAL TO MAKE REAL ESTATE LOANS UNLESS SECURED OR GUARANTEED BY MORTGAGE INSURANCE, THE REFUSAL TO GRANT LOANS WITHOUT BURDENSOME TERMS, AND THE REFUSAL TO GRANT A LOAN OR PROPERTY OLDER THAN A CERTAIN AGE.

MORE SIGNIFICANTLY, THE CRA HAS PLAYED A NEW ROLE IN RECENT YEARS. WITH THE DEREGULATION OF INTERSTATE BANKING, MORE AND MORE BANK

HOLDING COMPANIES ARE MERGING WITH OR ACQUIRING BANKS IN OTHER STATES. AS A RESULT OF THIS INCREASE, PUBLIC INTEREST GROUPS AND NEIGHBORHOOD ACTION COMMITTEES ARE USING THE CRA TO PUBLICLY CRITICIZE AND LEGALLY CHALLENGE BANK CREDIT POLICIES WITH RESPECT TO LOW- AND MODERATE-INCOME CUSTOMERS AS A CONDITION TO THE PROPOSED MERGERS.

I CAN APPRECIATE THEIR CONCERNS. BANK DEREGULATION, THE RISE IN BANK MERGERS AND ACQUISITIONS, EVER-INCREASING COMPETITION, THE DECLINE IN FEDERAL FUNDING FOR LOW-INCOME HOUSING AND OTHER URBAN PROGRAMS HAVE TRIGGERED MUCH OF THIS COMMUNITY ACTIVISM. HOWEVER, IN SOME INSTANCES ALLEGATIONS HAVE BEEN MADE THAT COMMUNITY ACTIVISM HAS GONE BEYOND MERE LEGAL CHALLENGES UNDER THE CRA. INSTEAD, THERE ARE REPORTS OF INSTANCES WHERE SOME COMMUNITY GROUPS HAVE USED THE CRA TO EXTRACT APPLICATION WITH THE REGULATORY AGENCY. AND WHILE I'M NOT OPPOSED TO NEGOTIATED SETTLEMENTS BETWEEN THE BANK AND THE COMMUNITY, I AM CONCERNED WHEN SUCH SETTLEMENTS MAY BORDER UPON EXTORTION AND PERHAPS UNDERMINE THE SAFETY AND SOUNDNESS OF THE BANK INVOLVED.

MR. CHAIRMAN, I HOPE THAT OUR WITNESSES WILL ADDRESS THESE ISSUES TODAY AS WE EXAMINE THE PROGRESS MADE UNDER THE CRA. I LOOK FORWARD TO THEIR TESTIMONY.

## OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

Welcome to the oversight hearings marking the 10th anniversary of the Community Reinvestment Act. Congress approved CRA as part of the campaign to revitalize our inner cities and to combat redlining. CRA was written, as I said, 10 years ago because "There is no way the Federal Government can solve that problem with its resources." The private sector has the capital, the know-how, and the efficiency to do the job, but the record shows that we have to nudge them and influence them and persuade them to invest in their community.

Now if that was true 10 years ago, it's far more true now with our sensitivity to the deficit and the limitations on Federal spending and Federal investment.

What does CRA do? First, it makes crystal clear that federally regulated or insured lenders have an affirmative obligation to make loans in their communities. The loans naturally must be sound, as Arthur Burns said, taking that into account. The first obligation of a banker is to meet the credit requirement of his service area.

Second, the CRA requires regulators to rate the lenders' reinvestment performance and to take this evaluation into account when deciding to approve or deny an application to change banking operations.

We are here to ask two basic questions. Have lenders fulfilled their affirmative lending obligations? Have regulators met their legal responsibilities?

To answer these questions we've invited distinguished community leaders, researchers, mortgage industry executives, and bankers to share their views. Tomorrow we will hear from the regulators.

What have we heard so far? Some estimate that the law is responsible for generating some \$5 billion in loan commitments to lower income neighborhoods. Others say CRA provides a new and real opportunity to rebuild neighborhoods both physically and socially. Most agree that CRA helps foster a sense of community and that it has led to a greater appreciation of the investment opportunities that exist in one's own backyard.

Let's face it. Redlining hasn't disappeared. Neighborhoods are still starving for credit. Too many bankers still think the grass is greener elsewhere. That \$5 billion pledge for developing neighborhoods is peanuts compared to the \$100 billion loans to developing countries.

Regulators seem to think that we're all living in Lake Woebe-gone. Like the children of the fictional village, U.S. lenders are all above average. Almost all get high ratings year after year and almost none is ever held back.

The committee surveyed CRA rating procedures and found that more than 97 percent of all lenders passed with flying colors. What's more, in the last 10 years, only 8—that's 8 of 40,000 applications reviewed by the agencies were denied. I wish we had graders like that when I was in school.

And I ask myself, how is it that so many neighborhoods are continuing to fail while so many lending institutions are continuing to

pass? This record, needless to say, raises questions about whether the examination process has succeeded. This record fails the nudge test which for me is an essential measure of progress under CRA.

Now I understand we're starting off with a video report which you can see from there and I can look up here and see. I hope you can all get in a position where you can watch it.

[Video report of "Dallas TV" show was given.]

The CHAIRMAN. Senator Garn.

#### OPENING REMARKS OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

I would just like to apologize for coming late and leaving early, but as usual, we have conflicts. Senator Proxmire and I not only are chairmen and ranking on this committee, we are on the HUD and Independent Agencies Subcommittee as well. And it's meeting at exactly this same time and I have been down there. That's the appropriations side of our responsibility. The chairman has been up here and I've been trying to defend us down there, so I just wish to make that statement of our divided responsibilities this morning. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator.

Do you have a statement, Senator Graham?

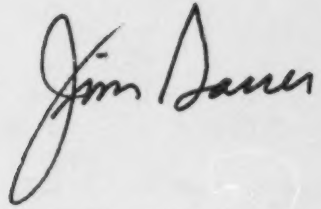
#### OPENING REMARKS OF SENATOR GRAHAM

Senator GRAHAM. Mr. Chairman, I do not have an opening statement, but I want to commend you for scheduling this oversight hearing and I look forward to increasing my knowledge of what has happened under this program during the past decade.

For the States that are experiencing rapid growth like mine in Florida, efforts such as this to see that growth sheds its prosperity and increased opportunity on all of our people is especially important, and this initiative to try to bring the public and private sectors together in a financial marriage for the benefit of the community is a creative one and I look forward to seeing the report card.

The CHAIRMAN. Well, ladies and gentlemen, we're delighted to have you as witnesses. You're community leaders. You've done an excellent job of working with this legislation in the past and we're very grateful to you for the work you've done, and I'm sure your communities are, too.

Before we begin, I have a statement of Senator Sasser to be inserted in the record.



STATEMENT OF SENATOR JIM SASSER, BANKING COMMITTEE, MARCH 22,  
1988

MR. CHAIRMAN, THE COMMUNITY REINVESTMENT ACT WAS ENACTED SOME TEN YEARS AGO WITH THE SEEMINGLY LOGICAL GOAL OF ENCOURAGING FINANCIAL INSTITUTIONS TO INVEST IN THEIR LOCAL COMMUNITIES. OUR BANKING SYSTEM IS BUILT ON A SCHEME OF GIVE AND TAKE. CONGRESS CONFERS CERTAIN ADVANTAGES AND PROTECTIONS ON FINANCIAL INSTITUTIONS, IN EXCHANGE FOR WHICH FINANCIAL INSTITUTIONS ARE SUPPOSED TO PURSUE, TO SOME EXTENT, CERTAIN ECONOMIC AND SOCIAL GOALS.

IT IS CONGRESS' DUTY TO CONTINUALLY MONITOR THE SITUATION. IT IS OUR JOB TO MAKE SURE THAT THE REGULATORS AND LENDERS ARE DOING THEIR JOBS.

MR. CHAIRMAN, I AM PLEASED THAT THE COMMITTEE IS CONSIDERING THE ISSUE OF NEIGHBORHOOD REINVESTMENT TODAY AND LOOK FORWARD TO THE TESTIMONY OF THIS IMPRESSIVE LIST OF WITNESSES. THANK YOU.

The CHAIRMAN. Ms. Uebelhoer.

Ms. UEBELHOER. Senator Proxmire, unfortunately, Mrs. Brown was forced to cancel her plans to come to Washington at the very last minute. I'm legislative representative for ACORN and I'm joined at the table by Mrs. Frances Riley, who's an ACORN member from Washington, DC.

With your permission, I will deliver Mrs. Brown's remarks.

The CHAIRMAN. Go right ahead.

**STATEMENT OF JANE UEBELHOER, LEGISLATIVE REPRESENTATIVE, ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW**

[The complete prepared statement of Mildred Brown follows:]





Testimony presented by ACORN to the  
Senate Committee on Banking, Housing and Urban Affairs  
on  
The Community Reinvestment Act  
March 22, 1988

Good Morning, Chairman Proxmire, Senators, and distinguished guests. I am  
INE UEBELHOER, appearing for Mildred Brown, President of ACORN, the  
Association of Community Organizations for Reform Now. Unfortunately, Ms.  
Brown was forced to cancel her plans to be here today.

ACORN applauds you for holding these hearings into the enforcement of the  
Community Reinvestment Act (CRA), and related issues. When you and your  
Committee have heard what we have to say, we know that you will do  
whatever is necessary to ensure that banks begin to fulfill their legal  
obligations to meet the credit and deposit needs of low and moderate income  
americans.

Senator Proxmire, ACORN's 75,000 member families, and countless other  
low and moderate income people around the country, gratefully acknowledge

Association of Community Organizations for Reform Now  
Organizing and Support Center: 401 Howard Street, New Orleans, Louisiana 70130 (504) 523-1881  
Home Offices: 523 W. 18th Street, Little Rock, Arkansas 72202 (501) 376-7151  
National Office: 522 8th St., S.E., Washington, D.C. 20003 (202) 547-4292

your years of leadership in demanding that financial institutions make  
credit available in our communities. The Community Reinvestment Act is an  
important part of the great legacy you will leave the country.

The major points ACORN will raise in oral and written testimony at this  
hearing are:

•Most financial institutions continue to engage in practices that  
discriminate against low income people and racial minorities.

•The federal regulatory agencies charged with enforcing CRA and fair lending  
laws allow financial institutions to discriminate, and increasingly, shield  
banks from community groups.

•When community groups move mountains, CRA can work in spite of all this.  
But we need Congress to intervene to improve enforcement of CRA.

•Policies of the secondary mortgage markets and private mortgage insurers  
also discriminate against low income people and racial minorities, and  
undermine the efforts of lenders who want to make credit available to these  
groups,

and that therefore,

•Congress should act now to put teeth in the CRA examination process,  
make fundamental reforms in the CRA rating system, require disclosure of  
CRA ratings and evaluations, and demand that regulators deny applications  
by banks with poor CRA performance records.

ACORN was asked to concentrate in our oral testimony on experiences with  
the Office of the Comptroller of the Currency, and on our CRA challenge of  
Hibernia National Bank. (ACORN's written testimony addresses a broader  
range of issues. We urge all interested parties to review our written  
remarks.)

#### Hibernia and The OCC

In October 1985 ACORN and Local 100, Service Employees International Union, protested an application by Hibernia National Bank in New Orleans to acquire a bank in Lafayette, Louisiana. After a delay of 8 months, the Federal Reserve Board issued an order approving the merger.

Geraldine Bell of New Orleans, Secretary of ACORN's National Association Board, made the following statement on the Hibernia case and the OCC at a hearing in House Banking Committee chambers in July 1986. After quoting Ms. Bell, I will tell the alarming story of developments in the Hibernia case since 1986.

"I want to tell you about the biggest outlaw in the state of Louisiana...our largest bank: Hibernia National Bank. Hibernia is guilty of racial discrimination--pure and simple. New Orleans is 60% Black, and yet 1984 HMDA data shows that this bank loaned only 4.6% of its home mortgage money in Black neighborhoods, but 32% of its mortgage money to areas which are 80% or more white. Hibernia loaned 7 times more home purchase money to white neighborhoods than to black neighborhoods. In my city, half the population lives in low and moderate income census tracts, but only 10.5% of Hibernia's mortgage loan money went to low and moderate income neighborhoods.

Hibernia is a leading SBA-guaranteed small business lender in suburban Jefferson Parish, which is nearly all white, but the bank has not made one single SBA loans in Orleans Parish, which is mostly Black.

Hibernia is a giant vacuum cleaner that sucks money out of poor and Black neighborhoods and then loans it in affluent, mostly white areas. Let me give you just one example of this. In 1984 the St. Claude branch of Hibernia, which is located in my neighborhood, had \$18 million in deposits. These deposits came from the mostly Black and poor people living in the neighborhood. And yet, Hibernia loaned back to my neighborhood less than 1% of these deposits--only \$98,000--in housing loans, which is the type of credit our community needs the most.

Now you may wonder how it is that a federally chartered national bank as big as Hibernia could still get away with racial discrimination. After all, it is 9 years since the Community Reinvestment Act was passed and over 20 years since the civil rights laws were passed.

The answer lies in the fact that the primary regulator of Hibernia National Bank is an even bigger outlaw named the Comptroller of the Currency. The Comptroller believes that banks should be allowed to do whatever they want to do. In the name of deregulation the Comptroller has taken it on himself to ignore the community protection and anti-discrimination laws passed by the Congress of the United States.

Thus, for the last few years, whenever the Comptroller's office has examined a national bank they have simply not even bothered to look for violations of the CRA, Equal Credit Opportunity Act nor other federal laws which are supposed to protect communities. This has led to increased redlining and discriminatory lending practices by national banks throughout the country...

in city after city and every region throughout the country ACORN is finding that the Comptroller, and other regulators, are letting banks turn their backs on the needs of working people and minorities.

Fortunately for us in New Orleans, we found a way to bypass the Comptroller and file a Community Reinvestment Act challenge against Hibernia with the Federal Reserve Board. While investigating our charges, the Fed found that the CRA exam of Hibernia which had been completed by the Comptroller less than one year earlier was totally inadequate.

Our challenge against Hibernia set several important precedents:

--Hibernia's application was blocked for 8 months and cost the bank tens of thousands of dollars. This was the longest delay in the history of CRA challenges.

--The Federal Reserve Board held the first public meeting ever held in the South and only the third held since passage of CRA.

--Hibernia was ordered to increase its home lending to low and moderate income areas.

--For the first time ever, the Federal Reserve Board took CRA enforcement away from the Comptroller's office."

This testimony delivered by Geri Bell in 1986 calls out some of the facts about Hibernia and the OCC. I will briefly expand upon and update these issues.

The OCC, in its examination of Hibernia's community reinvestment record, gave the bank a satisfactory rating; in contrast, the Federal Reserve Board, which was required to examine Hibernia's record just a year later in the course of ACORN's CRA challenge, was extremely critical of the bank's performance. The Fed found that Hibernia had never undertaken an assessment of the community's credit needs; had no procedure in place or personnel to enforce CRA requirements; and was not even keeping the necessary fair lending data.

#### Cause for Outrage

This story should have a positive ending. \$2 million dollars of new loan money should be flowing into our neighborhoods from Hibernia every year, and the bank should have developed a new and highly cooperative relationship with the low and moderate income residents in its service area. But instead we have no evidence that Hibernia has taken a single step to comply with the Federal Reserve order. A week ago today, March 15, ACORN leaders met with community affairs officers at the Federal Reserve Bank in Atlanta and were told that, incredibly, Hibernia had not filed any of the documents called for by the order. --although the bank has been required to file a plan within 90 days and to submit progress reports every six months.

It has been decided in Washington that anything submitted to the Fed as the result of a Fed Board Order is proprietary information that should be considered confidential. This decision has become the policy for handling the growing number of similar situations. The Fed has decided to shield the, and leave the community totally in the dark.

**Written Testimony  
Submitted by**

**Mildred Brown  
President of ACORN  
(The Association of Community Organizations for Reform Now)**

**to**

**Senator William Proxmire  
Chairman  
The Committee on Banking, Housing and Urban Affairs  
United States Senate**

**for**

**Hearings on  
The Implementation and Enforcement of the  
Community Reinvestment Act of 1977**

**held**

**March 22, 1988**

Good Morning, Chairman Proxmire, Senators, and distinguished guests. I am Mildred Brown, President of ACORN, the Association of Community Organizations for Reform Now. ACORN is the nation's largest grassroots membership organization of low and moderate income people.

ACORN applauds you for holding these hearings into the enforcement of the Community Reinvestment Act (CRA), and related issues. We hope that these hearings will result in a major shift in the actions and practices of bankers and regulators. When you and your Committee have heard what we have to say, we trust that you will do whatever is necessary to ensure that banks begin to fulfill their legal obligations to meet the credit and deposit needs of low and moderate income Americans.

Senator Proxmire, ACORN's 75,000 member families, and countless other low and moderate income people around the country, gratefully acknowledge your courageous leadership during your years in Congress in demanding that financial institutions meet their responsibilities to make credit available in our neighborhoods. The Community Reinvestment Act is part of the great legacy you will leave the country. ACORN regrets you have decided to retire. We hope you are working closely with other Members of Congress to guarantee continued support for the Community Reinvestment Act in the years to come.

#### **The Main Points Raised in ACORN's Testimony**

- Most financial institutions continue to engage in practices that discriminate against low income people and racial minorities.
- The federal regulatory agencies which are charged with enforcing CRA and fair lending laws permit financial institutions to discriminate, and increasingly, shield banks from efforts by community groups to get private lenders involved in neighborhood revitalization projects.
- Policies of the secondary mortgage markets and private mortgage insurers also discriminate against low income people and racial minorities, and additionally, undermine the efforts of lenders who want to make credit available to these groups.
- Due to the blood, sweat and tears of low income community groups, CRA has been somewhat effective in spite of all this. But we have now reached a stage when we need Congress to intervene to improve enforcement of CRA.

ACORN was asked by your staff to concentrate in part on experiences with the Office of the Comptroller of the Currency, and on our CRA challenge of Hibernia National Bank, New Orleans.



## Hibernia and The OCC

In October 1985 ACORN and Local 100, Service Employees International Union, protested an application by Hibernia National Bank in New Orleans to acquire a bank in Lafayette, Louisiana. After a delay of 8 months, the Federal Reserve Board issued an order approving the merger. The order required the bank to undertake more community reinvestment activities than had any previous order. Hibernia was directed to make \$2 million annually in FHA insured and VA guaranteed mortgage loans to low and moderate income census tracts and to meet with ACORN and other community groups as part of an effort to do a complete reassessment of community credit needs. The order also required the bank to make regular reports on their progress towards implementing this order to the Federal Reserve Bank of Atlanta rather than to ACORN or to the bank's normal line regulator, the southwest OCC regional office in Dallas.

Geraldine Bell of New Orleans, Secretary of ACORN's National Association Board, made the following remarks on the Hibernia case and the OCC at a hearing in House Banking Committee chambers in July 1986. After quoting Ms. Bell, I will tell the alarming story of developments in the Hibernia case since 1986, and then contrast our experience in New Orleans with progress made in my home town, Philadelphia.

"I would like to begin my testimony by telling you about the biggest outlaw in the state of Louisiana...our largest bank: Hibernia National Bank. Hibernia is guilty of racial discrimination--pure and simple. New Orleans is 60% Black, and yet 1984 HMDA data shows that this bank loaned only 46% of its home mortgage money in black neighborhoods, but 32% of its mortgage money to areas which are 80% or more white. Hibernia loaned 7 times more home purchase money to white neighborhoods than to black neighborhoods. In my city, half the population lives in low and moderate income census tracts, but only 10.5% of Hibernia's mortgage loan money went to low and moderate income neighborhoods.

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deposits. These deposits came mostly from the black and poor people living in the neighborhood. And yet, Hibernia loaned back to my neighborhood less than 1% of these deposits--only \$98,000--in housing loans, which is the type of credit our community needs the most.

Now you may wonder how it is that a federally chartered national bank as big as Hibernia could still get away with racial discrimination. After all, it is 9 years since the Community Reinvestment Act was passed and over 20 years since the civil rights laws were passed.

The answer lies in the fact that **the primary regulator of Hibernia National Bank is an even bigger outlaw named the Comptroller of the Currency.** The Comptroller believes that banks should be allowed to do whatever they want to do. In the name of deregulation the Comptroller has taken it on himself to ignore the community protection and anti-discrimination laws passed by the Congress of the United States.

Thus, for the last few years, whenever the Comptroller's office has examined a national bank they have simply not even bothered to look for violations of the CRA, Equal Credit Opportunity Act nor other federal laws which are supposed to protect communities. This has led to increased redlining and discriminatory lending practices by national banks throughout the country...

In city after city and every region throughout the country ACORN is finding that the Comptroller, and other regulators, are letting banks turn their backs on the needs of working people and minorities.

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Our challenge against Hibernia set several important precedents:

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the South and only the third held since passage of CRA.

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This testimony delivered by Geri Bell in 1986 calls out some of the facts about Hibernia and the OCC. I will briefly expand upon and update these issues.

ACORN's challenge to Hibernia Bank's CRA record demonstrated that the OCC does not closely examine the national banks that it regulates on community reinvestment issues. The OCC, in its examination of Hibernia's community reinvestment record, gave the bank a satisfactory rating; in contrast, the Federal Reserve Board, which was required to examine Hibernia's record just a year later in the course of ACORN's CRA challenge, was extremely critical of the bank's performance. The Fed found that Hibernia had never undertaken an assessment of the community's credit needs, had no procedure in place or personnel to enforce CRA requirements, and was not even keeping the necessary fair lending data.

### Cause for Outrage

This story should have a positive ending. \$2 million dollars of new loan money should be flowing into our neighborhoods from Hibernia every year, and the bank should have developed a new and highly cooperative relationship with the low and moderate income residents in its service area. But instead we have no evidence that Hibernia has taken a single step to comply with the Federal Reserve order. A week ago today, March 15, ACORN leaders met with community affairs officers at the Federal Reserve Bank in Atlanta and were told that, incredibly, Hibernia had not even filed its first progress report, --although the bank has been required to file a report every 90 days for the past two years ago.

Earlier, ACORN tried to get copies from the Federal Reserve Board in Atlanta of the reports that we assumed were being submitted by Hibernia. The head of the examinations department said he would send the reports. But this official was apparently told by the a Fed lawyer in Washington that anything submitted to the Fed as the result of a Board order is proprietary information that should be considered confidential. This decision has become the policy for handling the growing number of similar situations The

Fed has decided to shield the bank and leave the community totally in the dark.

So ACORN members and other low income people have been treated to a double indignity by the bankers-regulators in this case: having spent months proving conclusively that Hibernia is a terrible bank, and apparently having won some redress from the Federal Reserve Board, we are first told that we will not be permitted to view evidence of the bank's progress towards meeting its goals, and are ultimately told that the bank has not even produced the first shred of proof that it has done a thing meet its goals.

Finally, ACORN was assured that no further applications by Hibernia would be approved until the bank showed itself to be in compliance with the Fed order. Sources inside the agency tell us, though, that this is not the case -- two Hibernia applications have been approved in the meantime.

And, by the way, an ACORN member went to a Hibernia branch last week to open a basic checking account and learned that there was an opening balance requirement of \$300. She was turned away by the bank employee with the remark the "banks aren't for poor people anymore."

### **Another Blunder**

In the Hibernia case, the OCC, amazingly, failed to notice that the bank was not keeping fair lending data. The Center for Community Change (CCC) caught the OCC in another basic flub last year. CCC discovered that Community First National Bank of Pleasanton, Calif., submitted their HMDA reports on the wrong forms for three consecutive years. OCC did not even notice this blatant error. (See attachment)

### **More Problems with the OCC**

Another recent experience with the Comptroller reaffirms our cynicism. The First National Bank of Commerce in New Orleans recently made application to the OCC to open branches in other parishes. ACORN protested this application because First NBC's record of providing services to low and moderate income people in their service area was abysmal. The OCC was of no help in encouraging meetings and negotiations between ACORN and the bank, and were repeatedly met with evasions about when OCC would reach a decision about the application.

The agreement ACORN signed with First National Bank of Commerce contained the bare bones of a beginning to meet the credit needs of low

income people in New Orleans. In our judgment, this agreement neither meets those needs at the level at which First NBC is capable of meeting them, nor at a level at which First NBC is responsible for meeting them. And not only ACORN, but also the bank, was displeased with the OCC's role in this process.

### **The Regulators Who "would not attend public forums"**

Three weeks ago ACORN invited representatives of each of the four regulatory agencies to a meeting in Atlanta so that low income people could tell the regulators their stories about how they are being treated by Atlanta banks. One women, for example, wanted to give the details of a visit to Citizens and Southern National Bank in which "I met with a white male vice president of the bank. When I asked him what I needed to do to apply for the loan, he did not give me an application. Instead, he told me that what I needed was a "sugar daddy". (See attachment)

Only the Federal Home Loan Bank Board accepted our invitation to the neighborhood meeting in Atlanta. The Federal Reserve Board and the OCC declined on the grounds that they "do not attend public forums". But it is our understanding that as we sit here this morning the regulators are "attending a public forum", a bankers' convention in Atlanta. And it is also my understanding that these hearings were postponed from last week to this week because the heads of the regulatory agencies were "attending a public forum", a bankers' convention in Hawaii.

### **The Big Picture with the OCC**

The overall pattern of the OCC's CRA ratings confirms that the Hibernia situation is not out of the ordinary. In 1984, for example, only one out of the nation's 245 largest banks received less than a satisfactory rating. Given the facts that the Fed uncovered behind the Hibernia rating, ACORN strongly believes that these ratings do not accurately reflect the actual performance of banks in meeting their community reinvestment responsibilities.

It is possible to see why these ratings are so inflated when you look at the procedures that the OCC follows. In the first place, the OCC does not carry out separate CRA examinations; instead, examiners whose first concern is safety and soundness are asked to tack CRA exams on as an afterthought. Second, OCC examiners are not required to meet with community groups to determine community credit needs, much less how well the bank is meeting those needs. The OCC agreed to schedule such meetings in eight cities after ACORN met with top OCC officials in 1986, but we have no reason to believe

that this will become an ongoing program.

And the Comptroller himself, at a meeting with community and consumer representatives in April 1986 argued that competition rather than regulation will force banks to meet their community reinvestment obligations -- an assertion directly counter to the mandate of the CRA.

### **Redlining in New York**

ACORN recently filed a petition with the Federal Reserve Board to block the takeover of Irving Trust Company by the Bank of New York. After proving that both banks were flagrantly breaking the law, ACORN got Bank of New York to the table to negotiate and eventually sign a major CRA agreement. Both Irving Trust and Bank of New York were in violation of the law by defining their service areas to exclude low income neighborhoods. And the banks failed to meet the CRA requirements for "affirmative" investment in poor communities. Bank of New York invested only 1.8% of its mortgage money in Manhattan's five poorest community districts where 39% of Manhattan's residents live. Brooklyn's seven poorest districts received only 13% percent of Bank of New York's mortgage and home improvement loans, and only 1% of Irving's mortgage and home improvement loans.

Put another way, one-third of Brooklyn's population lives in these seven districts. Irving Trust invested \$12 per person in the 11 most prosperous community districts and 21¢ per person in Brooklyn's seven poorest community districts.

Where have the regulators been?

### **Success with CRA: The Other Philadelphia Story**

Philadelphia ACORN negotiated two strong CRA agreements with local banks in 1985-86: Continental Bank and Fidelity Bank. And the ACORN Housing Corporation of Pennsylvania has seen to it that these agreements have paid off in low income lending and housing development.

The first year performance of the ACORN/Fidelity agreement was extremely impressive. All program goals were met, and Fidelity increased its lending to low and moderate income communities in Philadelphia by more than ten fold. In 1982 Fidelity made 12 mortgage loans in majority black census tracts; after the first year of the program the bank had lent \$18.35 million to the targeted low and moderate income census tracts, most of which are majority black. This \$18.35 million included 290 first mortgages totaling



\$5.5 million. Perhaps most significantly, the default and rejection rates under this program was better than the banks' overall rates. Fidelity has now become the main low income lender in Philadelphia.

ACORN's program performance was the key to its success. In June, 1986, ACORN established a loan counseling, marketing and pre-packaging center. During the program's first year, over one-third of the low income mortgages approved by Fidelity were referred from our center. Furthermore, people who went through our center's counseling program had an approval rate of 76% --much higher than the bank's overall rate.

The first year performance of the ACORN/Continental Bank program was also very impressive. In 1985, the year prior to the agreement, Continental made only 15 housing loans to black majority census tracts in Philadelphia. After 11 months of our program, Continental had made nearly \$4.8 million in housing related loans in these same areas, including 162 Title I home improvement loans and 71 first mortgage loans. The bank had also made 13 small business loans totalling \$400,000.

But barriers built by the Private Mortgage Insurers and secondary mortgage market agencies are threatening our work in Philadelphia, and our other CRA agreements. Because neither Fannie Mae nor the PMIs will look at a loan made on a house on a block where more than 15% of the properties are abandoned --and just about every block in our neighborhoods in Philadelphia has at least 15% abandonment -- both Fidelity and Continental have been forced to keep all of the loans they have made under the ACORN agreement in they portfolios. This seriously limits the banks' ability to keep money flowing to revitalize our communities.

### **Successes in St. Louis**

Missouri ACORN has negotiated five major Community Reinvestment Act agreement--with Boatman's, South Side National, Landmark, Mark Twain and Missouri State Banks --plus another four agreements which deal specifically with lifeline deposit accounts.

One example: In St. Louis, a city with serious housing problems, Boatman's Bank, owned by the state's largest bank holding company made no home mortgage loans in 1982 and 1983, and when the bank did begin making mortgage loans in 1984, only 8% were made in the City of St. Louis, with the remainder being made in more affluent St. Louis County. Furthermore, during those same years the bank made only between 7% and 13% of its home



improvement loans in census tracts where housing values were below the St. Louis median.

When General Bancshares Corp. applied to acquire Boatman's Bankshares, Inc. ACORN challenged that application on CRA grounds and won a commitment from Boatman's to invest \$50 million a year in low income housing in St. Louis. Among other provisions, the signed agreement between ACORN and Boatman's set up a joint ACORN-bank review committee to assess the progress of the drawdown of the money.

Ethan A.H. Shepley, Jr., vice chairman of Boatman's, speaks very favorably of the agreement his bank reached with ACORN, stating that the results of such agreements can be good for a bank. "We're being held up as the heroes, and that's super. That's the kind of publicity we love. And we've not making any loans that we feel are bad".

Lifeline accounts developed after negotiations with Missouri ACORN are bringing thousands of new customers through bank doors. Charles E. Silva, Jr. Executive Vice President of Landmark Bank reports that his bank opened 2,000 "Pay As You Go" accounts last year, bringing the total of lifeline customers to 7,000. And Merchantile Bank had 2,675 "Budget Checking Accounts" as of Sept. 1987. (See attachment)

### **How the Secondary Markets and PMIs are Tripping Us Up**

The large secondary market agencies and Private Mortgage Insurers are raising serious roadblocks to the implementation of CRA agreements. In recent years the PMI companies and FNMA and FHLMC have adopted certain underwriting criteria which effectively redline inner city neighborhoods and unnecessarily discriminate against low-income borrowers. As a result, in some cities the banks which are fulfilling their CRA agreements by greatly increasing mortgage lending in inner city neighborhoods are being forced to hold nearly all these loans in their portfolios.

In the past, community groups have found it difficult to tell just whose underwriting guidelines are at fault: the banks', the PMI companies' or the secondary market agencies'. Traditionally they point the finger at each other.

However, the partnership formed between community groups and banks as a result of CRA agreements has altered this situation. ACORN groups in Philadelphia, for example, have seen the banks with which they have agreements place large numbers of low income housing loans in their

portfolios, and have reviewed rejection letters from the PMI companies and FNMA. ACORN leaders are convinced that the PMI companies, FNMA and FHLMC are to blame for most of the problems.

A sampling of the barriers we have identified:

- \*Prohibitive initial costs: Purchasers are often required to hold two months housing payments in escrow in addition to downpayment and closing costs. These lump sum costs often prevent low income people who can meet monthly payments from buying a home.
- \*Minimum loan size: PMI companies admit that they have a \$30 thousand minimum loan size in certain areas, but in many places it is hard to find a house for more than \$30 thousand.
- \*Credit ratings: Increasingly, only spotless credit ratings are accepted and only the most narrow explanations of blemishes are allowed.
- \*Employment history: It is required that a purchaser have two years employment at the same job, disqualifying people who have had gaps in employment.
- \*Source of income: The secondary markets and PMIs refuse to consider total annual income regardless of source. Money earned from part time work, public assistance, or free lance work is not counted as income. Food stamps are not recognized as income.
- \*Proof of source of downpayment: It is often required that a downpayment be in the buyer's account 90 days before settlement. Gifts are only acceptable as downpayment if they are from the immediate family, and gifts cannot make up more than 40% of the total downpayment. Sweat equity is not accepted towards downpayment.
- \*Abandonment ratio: Secondary market agencies and PMIs exclude dwellings located on blocks where more than 15% of the properties are abandoned. This redlines huge sections of many cities.
- \*Minimum down payment: Rather than require a percent of the purchase price as a downpayment, as is standard practice, some institutions set a minimum downpayment. For example, the minimum downpayment in Philadelphia, where you can buy many houses for \$10,000, is \$2,000. This screens out people without "front end money" who would qualify on normal percentage criteria.

So ACORN members and other low income people have been submitted to a double indignity by the bankers-regulators in this case: having spent months proving conclusively that Hibernia is a terrible bank, and apparently having won some redress from the Federal Reserve Board, we were first told that we will not be permitted to view evidence of the bank's progress towards meetings its goals, and were ultimately told that the bank has not even produced the first shred of proof that it has done a thing meet its goals.

Finally, ACORN was assured that no further applications by Hibernia would be approved until the bank showed itself to be in compliance with the Fed order. Sources inside the agency tell us, though, that this is not the case -- two Hibernia applications have been approved in the meantime.

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The overall pattern of the OCC's CRA ratings confirms that the Hibernia situation is not out of the ordinary. In 1984, for example, only one out of the nation's 245 largest banks received less than a satisfactory rating. Given the facts that the Fed uncovered behind the Hibernia rating, it is not hard to imagine that many of these ratings are suspect as well.

It is easy to see why these ratings are so inflated when you look at the procedures that the OCC follows. In the first place, the OCC does not carry out separate CRA examinations; instead, examiners whose first concern is

safety and soundness are asked to tack CRA exams on as an afterthought. Second, OCC examiners are not required to meet with community groups to ascertain community credit needs, much less how well the bank is meeting those needs. The OCC agreed to schedule such meetings in eight cities after ACORN met with top OCC officials in 1986, but we have no reason to believe that this will become an ongoing program.

And the Comptroller himself, at a meeting with community and consumer representatives in April 1986 argued that competition rather than regulation will force banks to meet their community reinvestment obligations -- an assertion directly counter to the mandate of the CRA.

Thank you for your close attention to our testimony.

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\*Arbitrary property standards: In Philadelphia, houses have been rejected because they had insufficient closet space. In Dallas and New Orleans houses that are built on wood posts do not qualify.

\*Credit history: Loans have been rejected because applicants have no credit history.

\*The 3% rule: If the buyer is making a 5% downpayment, FNMA won't permit the seller to put up more than 3% of the sales price of the house as settlement cost. This is a serious problem in cities where house prices are low and settlement costs are high.

\*Debt-to-Income ratios: Officers of PMIs and secondary market agencies are very inflexible on allowing exceptions to the standard debt-to-income ratios established by their underwriting criteria. We are familiar with cases that fell within the institutions' accepted guidelines but were rejected nonetheless.

\*Zoning: The PMIs and secondary markets refuse to buy or insure loans for properties in areas with mixed use zoning if those properties do not conform to the "highest and best use". This effectively redlines entire urban residential neighborhoods which have bordered commercial-industrial areas for decades, since commercial uses are ranked above residential uses.

### **The Root of the Problem with PMI and Secondary Market Policies**

ACORN leaders have been pressing these issues with the people in charge of these institutions. A landmark event in this campaign was a roundtable held in Washington, DC, during Sept. 1987, jointly sponsored by the ACORN and the American Bankers Association, and attended by community organizations, bankers, representatives of FNMA and FHLMC, and of the PMI industry. (See attachment)

In discussions during and after this roundtable, spokespeople for FNMA and FHLMC admitted that they set many guidelines on intuition, pulled out of the air from "common sense", and that they recognized the need to move more towards basing their decisions on actuarial data. The PMI representatives continue to insist that all of these are based on actuarial data -- but they won't disclose this data. The PMIs then go on to claim defensively that FHA should insure mortgages in low and moderate income areas, demonstrating a fundamental misunderstanding of the history,

purpose, and political realities of FHA.

The standards used by the PMIs and secondary market agencies appear to be based on classist and racist assumptions, with the consequence that large tracts of cities are redlined. These rules have the effect of discriminating against low income neighborhoods and racial minorities. The decisions about which standards will be employed are made in private but have substantial public impact.

And these arbitrary restrictions are jeopardizing ACORN's, and other community groups', CRA agreements with banks. ACORN knows that loans to low income people who live in the innercity are not exceptionally risky. If the PMIs and secondary market agencies continue to make decisions based on the assumption that these loans are risky, we demand to see the data!

### **A Solution to the PMI Problem**

Low and moderate income families who have cleared the many hurdles necessary to become home owners should not be stopped short by arbitrary and discriminatory policies issued behind closed doors by Private Mortgage Insurance companies. ACORN calls on Congress, under the leadership of the Senate Banking Committee, to extend disclosure requirements and fair lending laws to these institutions. ACORN would like assist the committee in this project in whatever ways we can.

### **A Cold Wind Blows through the Banking Regulatory Agencies**

Low and moderate income people need help from our elected officials. In bank after bank, city after city, state after state, the Community Reinvestment Act has been ignored by the federal banking regulatory agencies. Many banks in this country discriminate against racial minorities and low and moderate income neighborhoods. And the regulators not only let banks get away with this but increasingly tend to protect banks from the criticisms of community groups. Banks are breaking the law and the regulators are their accomplices.

For example, since early 1987, ACORN has observed a retreat on the part of the Federal Reserve System from its prior position of encouraging negotiations between banks and protesting community groups. This retreat is accompanied by a new hardline attitude towards negotiations and signed agreements on the part of an increasing number of bankers.

This backlash began appearing at the same time that the Board of Governors



was changing. Paul Volker, a man who knew of the CRA and reportedly authorized the Fed's system of resolving protests after he himself was the target of community protests, was replaced by Alan Greenspan, a man who had never heard of the Community Reinvestment Act before to his briefing prior to the Senate confirmation hearings. Governor Rice, the only black on the Board and reportedly the governor most sympathetic to CRA enforcement, retired and was replaced by a Reagan appointee. Martha Seger, who attempted to do away with Michigan's community reinvestment advisory commission when she was state bank commissioner, replaced governor Rice as liaison to the Consumer Advisory Council.

ACORN has good reason to believe that the attitude of the Federal Reserve Board towards CRA is decaying:

\* The new "Sid Sussan Rule": (Mr. Sussan is the Fed staff member in Washington, DC, who grants extensions of public comment periods on applications.) Since July 1987, ACORN has found that extensions are no longer routinely granted on public comment periods in order to facilitate negotiations or meetings between community groups and banks; rather, they are only granted if technical violations of notice requirements have occurred. After three different community groups had their requests for extensions denied, ACORN leaders confronted senior Fed officials who confirmed that there had been a change in procedure, but denied that this constituted a change in policy.

The fact that this does represent a significant policy shift was confirmed in November 1987 when Governor Seger told a group of community leaders at a conference on CRA in Chicago that she was not convinced that encouraging CRA agreements was in the best interest of anyone, and that the Board had ruled that decisions on applications had to be processed as fast as possible in order to protect the safety and soundness of the institutions involved.

\* The secret Seger meeting: In fall 1987, sympathetic staff members in Federal Reserve Banks and in Washington, DC, told ACORN of a private meeting Governor Seger held with a group of bankers who felt that the Fed was helping community groups to force banks into "extortionary" agreements. Ms. Seger and the head of the Fed's Community Affairs Division confirmed that the meeting took place. When questioned Ms. Seger stated that she thought the bankers had "some legitimate complaints".



\*The First Interstate/Allied Bancshares merger: Ten community groups from throughout the western United States formally protested this merger and attempted to negotiate settlements with First Interstate. In addition, four state ACORN organizations jointly attempted to negotiate an agreement without filing a protest. Research uncovered serious CRA violations at First Interstate banks in seven western states and at Allied Banks in Houston and Dallas. First Interstate refused to negotiate with any group.

Rather than encouraging a negotiated settlement with the community groups, the Fed stepped in to protect the bank from the groups. First Interstate and Allied were asked to submit CRA policy statements to the Fed. The documents that were submitted contained no specific goals or courses of action: rather, they were general, legalistic statements.

The Board order approving the merger applauded these policy statements and, in what has become an increasingly common move, ordered the banks to make yearly implementation progress reports to the appropriate Reserve Banks. Community groups were entirely removed from the process.

\*The Hibernia case: As explained at the beginning of my testimony, the Federal Reserve Board has permitted Hibernia Bank to ignore and violate a Fed order issued as the outcome of a protracted CRA challenge. Here's a bank the Fed was going to get tough with. They issued a relatively strong order but two years later there is absolutely no evidence that Hibernia is in compliance with that order. In the meantime, the Fed has approved other applications by Hibernia including one to make a major expansionary move into wealthy parishes in New Orleans.

A pattern has developed (e.g. Hibernia, First Interstate, Bank of New York) in which the Fed requires banks to make commitments and follow up with reports to the Fed, rather than encouraging banks to reach agreements directly with community groups. And the legal division at the Federal Reserve Board has made a conscious decision not to permit the public to see these reports. Will the Fed follow up on its orders and require banks to report regularly and in detail on their progress towards implementing mandated improvements? Why should community groups who have been cut out of this ongoing progress trust the regulators? Why should ACORN

trust the Federal Reserve Board when we look at Hibernia?

**Philadelphias are the Exceptions; Hibernias are the Rule.**

The productive partnerships created between banks and low income communities by the ACORN CRA agreements in Philadelphia and St. Louis are exceptional. The more typical response by bankers is the aggressive defiance shown by Hibernia. And unless we get help from Congress in reforming secondary market and PMI restrictions, even the Philadelphias are at risk.

So far, community groups have been asked to carry the entire load. Given the formidable obstacles we face and our lack of resources, we've had remarkable successes in a few cases.

But the situations in Atlanta (see attached Atlanta Journal-Constitution series) and New Orleans are the norm. Discriminatory lending patterns, like those in Atlanta, are typical. And what has been the response of the regulators? The Fed and OCC refused in Atlanta to merely come to a public meeting to discuss the community's complaints. In the Hibernia case, the OCC had examined the bank for compliance with CRA and related laws less than a year before ACORN's challenge. The OCC did not even uncover the fact that Hibernia was not keeping fair lending records. The regulators let banks get away with murder, before, during, and after community groups use the CRA challenge process.

By and large banks don't give a damn about the fact that neighborhoods within their service areas are literally falling to pieces for lack of credit. When a community group, like ACORN, can move mountains and persuade bankers to care, the Community Reinvestment Act has been an important resource.

We hope these hearings will be the first step towards radical improvements in the process. ACORN urges the Senate Banking Committee to exercise the leadership necessary to improve CRA, and require effective enforcement of this valuable law. Low and moderate income people throughout the country are counting on you.

## POLITICS AND POLICY

# Banks With Interstate Ambitions Are Challenged By Law Requiring Commitment to Local Lending

By CLARE ARMENT

*Staff Reporter of THE WALL STREET JOURNAL*  
Hibernia Corp., the New Orleans-based bank holding company, is discovering just how potent the federal Community Reinvestment Act has become.

Officials of the concern recently spent three hours defending their community lending record before federal regulators. A consumer activist group, which used the act to raise the lending issue, countered by offering testimony from several witnesses who claimed they were refused loans at Hibernia because of their race. Until the matter is resolved, Hibernia can't go ahead with a planned bank acquisition.

The nine-year-old Community Reinvestment Act requires banks to lend in their depositors' neighborhoods. Along with a companion measure, it bars lenders from "redlining," or refusing loans and other services to entire areas because of the race or economic class of their populations. Since the act's passage, more than \$1.7 billion has been committed in 117 cities for home mortgage, small business and other loans to predominantly low-income borrowers.

The CRA, however, has assumed even greater significance with the recent rise of interstate banking and the steady decline in federal funding for low-income housing. A bank's CRA record must be reviewed by federal regulators before an acquisition can be cleared. This requirement has given community groups, such as the one in New Orleans, a tool to block or at least delay a pending transaction until banks bargain with them over local lending practices.

In 1985, CRA protests jumped to 16 from three the previous year. Rather than risk costly delays, more and more banks, though defending their loan records to low-income borrowers, are negotiating community investment pacts with consumer activist groups.

## 'Consciousness-Raising Experience'

"The act has certainly given leverage to people who haven't had it and probably could use it," says one federal regulator. "It's been quite a consciousness-raising experience for many banks."

In Washington, D.C., for example, after a 20-group coalition filed a protest against United Virginia Bank's acquisition of NS&T (formerly National Savings & Trust) of Washington, D.C., the two sides negotiated an agreement. Among other things, the pact calls for United Virginia to try and make \$10 million in loans to low-income neighborhoods. The coalition says it previously had asked area banks to improve their lending, but "it was only when the bank had an appeal pending [for the acquisition] that we had real leverage."

contends attorney Allen J. Phibbs, in the Washington-based Center for Community Change. United Virginia acknowledged the agreement was triggered by community concern.

In Providence R.I., a computer printout of three years of home-mortgage lending patterns and a Brown University student's doctoral thesis on redlining in the state prompted one group to protest Fleet Financial Group Inc.'s purchase of two other banks. The group claimed Fleet discriminated against the increasing Indo-Chinese population. Fleet denied the group's contention, but agreed, among other things, to advertise in non-English publications, as well as earmark \$50 million in loans for low-income and moderate-income housing.

After a coalition of 37 Philadelphia-area community groups and churches opposed Fidelity Corp.'s purchase of IVE Financial Corp., Fidelity took several steps to placate the organizations. While it didn't pledge a certain dollar amount in loans, it agreed to make its "best efforts" to issue 115 new home mortgages and 200 home improvement loans and to increase that amount 10% during the next two years. In addition, it agreed for the first time to consider welfare checks, Social Security payments and food stamps as income for credit purposes.

## Hibernia Stalemate Unusual

Even the threat of a CRA protest can bring both sides to the table. In Duluth, Minn., a coalition's concerns about the depressed mining region prompted a meeting with First Bank System Inc. of Minneapolis. As a result, First Bank agreed to loan an additional \$4 million in the area and to sponsor a conference on meeting community needs. "I'm sure a consideration was avoiding a protest in the future," says Richard Simon, community affairs officer for the Federal Reserve Bank of Minneapolis. A First Bank spokesman concurs.

Concern over protests that could jeopardize multibillion acquisitions is typical, which makes the stalemate between Hibernia, with assets of \$5 billion, and the Association of Community Organizations for Reform Now (ACORN) all the more unusual. "Obviously, it's an expensive delay, but we're standing firm on our record," says Robert Oury, Hibernia's general counsel.

The Federal Reserve Board of Governors in Washington is expected to decide shortly whether the acquisition should be approved as proposed or whether Hibernia must adopt provisions to expand local lending.

These banks that do negotiate agreements staunchly defend their CRA record

and counter the protests largely without merit.

"It hurts your pride, sort of like attacking your family," says Lee M. Sessions Jr., senior executive vice president of Atlanta-based Citizens & Southern Corp. C&S's acquisition of a Florida bank last year was challenged by Florida community groups, which feared an out-of-state bank holding company would neglect black and low-income neighborhoods' needs. The probe was dropped after C&S explained its existing programs for minority and low-income areas.

The banking community has opposed the CRA from its inception, arguing that while well-intended, it's nebulous and costly, but the few attempts to repeal it act have failed. A consumer lobby seeks to toughen the CRA as it relates to interests acquisitions, a move opposed by the American Bankers Association, a trade group.

Community groups are banks playing more crucial role as federal sources neighborhood rehabilitation dry up. Bais are a likely target, not only because of CRA, but because declining interest rates have made credit more available to people with modest incomes.

"There's been tremendous cutbacks federal housing money. We have to look elsewhere for financing," says Michael Sheu of ACORN, which has been involved in CRA protests throughout the country. Michael Van Houskirk, vice president (Chatham, Ohio-based Hanc (The Cor said he think it's unfair that banks should be singled out, while limited-service banks such as Sears, Roebuck & Co.'s financial centers, remain untouched. "They're looking to banks to fill a hole," he says.

ACORN shares the same concern. "We're looking at those too," says Sheu. "It's just a matter of time."

The CHAIRMAN. Thank you for a very strong statement. We very much appreciate it.

Gale Cincotta is president of the National Training and Information Center, an old friend of the committee, and I should say young friend of the committee but for some period of time, and she's a person who's done a tremendous amount of fine work in this, not only in Chicago but throughout the country. I have the greatest admiration for the work you've done, Ms. Cincotta, and we're very grateful to you for it. Go right ahead.

#### STATEMENT OF GALE CINCOTTA, PRESIDENT, NATIONAL TRAINING AND INFORMATION CENTER

Ms. CINCOTTA. Thank you very much. I wanted also to thank you and the committee for finally giving us a permanent HMDA and applaud all of you for doing that because that to me is the centerpiece of making CRA work—having that data—and I would like to urge you to add one more thing to HMDA—the commercial loan data. As we move into having to create jobs in our neighborhoods, that data which we do have in Chicago by city ordinance has been very helpful in getting banks to loan money to businesses, mixed uses, storefronts with housing above, et cetera. So that that would be a very key centerpiece to move not only into housing loans but also the commercial, industrial loans that we need.

CRA has worked for the communities, but we never thought that we were going to be the people who were going to be the main enforcers of CRA.

Out of our office at NTIC, we can account for working with folks that would account for about \$1 billion in CRA agreements and loans in communities. And from our understanding, there is about \$4 billion total.

All of them have come from neighborhood protests, neighborhood agreements. The sad part is that we've had this law 9 years. Where the FDIC started with denying an application early on in 1979, we've only had eight denials since. So that the brunt of it has been on the community groups that continue to protest. We thought we were going to be in a partnership with the regulators doing more than they have been, and that it would be maybe the unusual cases that the community would have to go out and deal with the financial institutions.

I think that the regulators are doing the institutions a disservice also by giving them good ratings because every institution our groups have negotiated with have told us they've had good ratings and asked why are we at their door? Then we show their own HMDA data and our assessment and then we end up in a negotiating deal.

#### REDLINING

For myself, personally, redlining is alive. I don't move very often. A year ago, I changed my residence. I went to my local bank where I had my mortgage, my savings account, my checking account, and my IRA, and was offered a 5-year balloon mortgage only. I then went to a second, an S&L in the neighborhood—and this is 40-percent down, not a 5- or 10-percent—and was told that they couldn't



give me the mortgage because of Fannie Mae—they could not sell it on the secondary market.

It took going into a third institution where you knew somebody to get a mortgage. It's a 40-percent down on a bungalow on a double lot in the city of Chicago. So by personal experience, by working a group, redlining is still alive and working.

I could have gone to a bank we had an agreement on, but I wanted to see what my own bank and what the other banks in the neighborhood were doing. They all have good ratings by the Federal regulators.

The problems that I see happening with the Federal regulators right now is that up until now they didn't do very much themselves, but what's coming into play now is that they are making it harder for neighborhood activists groups to negotiate agreements. There is a time delay when you get an announcement if a bank is going to be in a merger or in an application process. Extensions aren't given automatically. What made our agreements work in Chicago is the Fed being able to give us extensions so we never had to go to a challenge, so that we had the time to work with the bank and never get into that immediate confrontation with them over a challenge. And we are hearing complaints from all over the country that this is happening, that the regulators want to move very fast on giving the banks what they want and not leave room for the community part to work.

The other thing that we find is that we have the regulators coming through our offices in Chicago regularly wanting to know how to do CRA, and what we find with the Federal Reserve Board folks that come in from the different districts is that we have to give them what the Washington Federal Reserve Board doesn't give them—a copy of the Federal Reserve Board regulations. We order them steadily from the Federal Reserve Board and always have them in our office to give to these folks. So that basic training is not happening.

The other problem we see, we did training for the OCC and they did a day of hard training on their regulators and brought in community people and bankers on what should be happening. At the end of the session, somebody from the Federal Reserve Board got up and talked about a bank in Chicago and said:

Now we've asked them to withdraw their application three times. They're still not doing a good job, but we finally let them do what they want because there was no community protest.

Now I know personally I've worked with that bank trying to get a neighborhood housing service program, et cetera, but what it said is here's a whole day of training where somebody from the Federal Reserve Board says:

You can go do a good job, this bank had a five, a bad rating, and we're still going to give them what they want unless there's a picket line out in front or something.

That to me was not how CRA was written.

#### NEED FOR ENFORCEMENT BY REGULATORS

What we need is the regulators to enforce and deny applications—enforce the CRA. We need the commercial loan disclosure.



We need a new CRA rating system. We need public disclosure of ratings. And we need comment period extensions.

I'd like to add there are two impediments to lending. One is by the private mortgage insurance industry, the MI's. What our data shows us and in my written testimony I'm submitting is that a lot of our agreements are for the 5-percent down fixed mortgages, where you have the lowest default rate. The highest default rate coming out of PMI is on mortgages with buydowns, graduated payments, negative amortization, which is what speculators use, and mortgages from EPIC that would be equivalent to how the banks lost money on the REIT's. The mortgage insurance companies were putting mortgage insurance on speculators and people that were playing the market that got hit in the 5th year by payment shock. But on fixed rate, 5-percent down mortgages, you had less than 1 in 100 in default. Yet that is the group now that can't get the private mortgage insurance.

The other piece is the secondary market. What seems to be happening in this industry, Fannie Mae, Freddie Mac, et cetera, is that there is no organizational history. When the Congress and you, Senator, in the late 1970's pushed them, they came up with anti-redlining, nondiscriminatory language in all their regulations and as in the 1980's, however, the regulations started to become tighter and tighter so that they start to look like only suburban tract developments can be put into the secondary market. Now you have to stretch them back out.

Fannie Mae, so far on the report card, has put back the antidiscrimination, antiredlining standards. They put the language back in on nonconforming zoning. They failed so far in putting in the borrower issues like 95 percent loan and income ratios. Freddie Mac to us is still failing on multifamily loans in that in our meetings with them they say, "We've got to bring Main Street to Wall Street. We've got to get a lot of packages together and sell them on Wall Street." Therefore, what that translates into to the Bronx, you bankroll speculators who don't put the money into rehabilitating that building, because the packages are bigger and you can sell those packages, and that for the nonprofits with smaller loan where the building will be rehabbed, they can't get it sold in the secondary market.

So I'm going to end at that point. I put all of this in the maps. One other thing is that you still cannot get HMDA and CRA data easily in banks and savings and loans. I've included this as a fourth letter from a bank in Tennessee to an individual trying to get ahold of their CRA statement.

In order to bring our correspondence with you to a permanent conclusion, I am enclosing a copy of our latest CRA statement that you requested. Be advised, however, that any and all future requests from you for any facts, figures or information from or about this bank must be presented to me in person in my office at the bank. I will require appropriate proof positive as to your identity in the event of such a presentation and I reserve the right to defer any and all such requests to legal counsel for determination of their validity and appropriateness.

That's to get a CRA or HMDA statement from a bank. It's from a bank vice president.

[The complete prepared statement of Gale Cincotta follows:]

# American Banker

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15th Year

## Hibernia National Bank Gets Fed Nod For Merger with Southwest National

Southwest Bureau

DALLAS — Hibernia National Bank in New Orleans on Tuesday received word that it had beaten back a challenge from Acorn, the community action group, and had received approval from the Federal Reserve Board for its merger with Southwest National Bank.

Acorn — the Association of Community Organizations for Reform Now — had objected to the merger with Southwest, based in Lafayette, La., seeking to force Hibernia to commit to investments in low-income neighborhoods. Community action groups increasingly have used complaints based on the federal Community Reinvestment Act to wrest such commitments from banks that have applied for mergers.

A spokeswoman for Hibernia said the approval was "precedent-setting" in that the Fed did not find the bank in violation of the reinvestment act. "The approval sets standards for other banks in meeting the requirements of the act," said the spokeswoman.

But Acorn officials said they under-

stood that the merger approval does require Hibernia to make periodic reports to the Fed on its compliance with the reinvestment act. That would be unusual for a national bank, which usually reports its reinvestment act compliance to the U.S. Comptroller of the Currency, said a spokeswoman for Acorn in Washington, D.C.

Fed officials did investigate the claims made by Acorn in the Hibernia case, an action that went beyond the Fed's usual reliance on reports about reinvestment act compliance supplied by the Comptroller.

Acorn also took solace in delaying the merger for six months. Hibernia officials conceded that the delay and the additional legal work cost the bank money.

The dispute came to a head at a rare public hearing held on May 3. Acorn coordinated testimony at the hearing that alleged redlining on the part of Hibernia. Bank officials said the group

Hibernia: Page 10

## Hibernia . . .

Continued from Page 1  
could not substantiate its claims.

The Fed agreed, saying that it could not find evidence of Hibernia's loans being determined on race or neighborhood, said an attorney for Hibernia.

The attorney, Gary Ryan, also noted that the ruling clearly stated that the reinvestment act was not meant to determine a bank's product mix, types of investments, or underwriting standards.

Acorn, though, noted that the Fed is requiring Hibernia to meet with community groups within the next 90 days — including Acorn specifically.

## Atypical ACORN

The Association of Community Organizations for Reform Now (ACORN), a consumer group, is making some unusual lobbying efforts.

On Thursday, ACORN members across the nation descended on 12 regional offices of the Comptroller of the Currency and demanded



tougher examinations and enforcement of consumer laws.

And they're pressing the House Banking Committee to hold a hearing on consumer banking problems during ACORN's July convention here — with ACORN members among the witnesses.

"We're going to be real people doing the lobbying instead of the smoothies who do it all the time," adds ACORN president Elena Hango of Little Rock, Ark.

Monday, June 30, 1986

**NTIC** National Training and Information Center  
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TESTIMONY OF  
GALE CINCOTTA, EXECUTIVE DIRECTOR  
NATIONAL TRAINING AND INFORMATION CENTER

BEFORE THE  
SENATE COMMITTEE ON BANKING,  
HOUSING AND URBAN AFFAIRS

March 22, 1988

Good morning. My name is Gale Cincotta and I am Executive Director of the National Training and Information Center, which works with community groups in, among other things, developing reinvestment partnerships with financial institutions. I'd like to start by thanking Senator Proxmire and the Senate Banking Committee for leading the way for the permanent extension of the Home Mortgage Disclosure Act. Along with the Community Reinvestment Act, this legislation can turn around the housing and economic problems of America's inner-city neighborhoods. Today, I'd like to briefly describe the obstacles that stand in the way of fulfilling that potential.

Next month, it will be nine years since the first rejection of a banking application due to a CRA protest by community groups. The FDIC denied a branching request by Greater New York Savings Bank because the bank made few loans in their lower-income service areas. In explaining the move, the FDIC stated: "We are going to uphold the law."

Today, that statement comes back to me as both a promise broken and a promise fulfilled. CRA promised inner-city residents that they would no longer suffer from arbitrary lending practices that forced many neighborhoods into a pattern of decline. Instead, lenders were expected to help build strong neighborhoods by meeting sound credit needs. CRA paid bankers the highest possible complement. It said: With your help, our neighborhoods will prosper. Without it, they will die.

If CRA praises the vitality of a sound, fair banking system, ~~then lenders are not willing to make the compromise.~~ In today's urban America, state-of-the-art condos and luxury highrises form a

backdrop against declining neighborhoods with less housing and less jobs. One underlying cause is clear from 1986 Home Mortgage Disclosure Act (HMDA) reports. Hundreds of census tracts in low-income America did not receive a penny in mortgage loans from reporting lenders. By contrast, most upper-income census tracts across the U.S. received from \$1 million to \$5 million in home loans each in 1986 alone. The promise to end redlining was broken.

The promise of CRA has been broken by each of the four federal banking regulators. Since CRA was passed, about 50,000 banking applications have been submitted to these agencies. Of these 50,000, only eight applications were rejected due to CRA. A bank president is about as likely to see an application rejected due to redlining as he is to crash on a commuter airplane. The extremely low odds of both may explain why many bank CEOs still see low-income neighborhoods only from the window of their private plane.

Regulators do not sanction lenders for redlining because they don't believe redlining exists. In 1986, 99 percent of all regulated institutions received a "1" or "2" CRA rating, indicating strong compliance. Only one lender out of 5,000 received a "5" CRA rating, meaning that they did not comply with the law. In fact, every lender that has signed a CRA agreement in recent years already had a "1" or "2" rating, even though many admitted they made little effort to make loans in inner-city neighborhoods.

At their very toughest, regulators have enforced CRA by conditioning the approval of a few applications on promises of future CRA progress. Conditional approvals are based on a notion that I call "no-fault redlining." While problems clearly exist, the regulators

blame them on "market failure" by communities rather than lending failure by banks. Since no one is to blame, punishment is replaced by planning. Conditional approvals force lenders to study everything and do nothing. As a result, several lenders that got conditional approvals in the early years of CRA actually made less loans afterward, and became the subject of a second CRA protest.

Bank of Indiana was one such repeat offender. In 1980, the OCC approved their merger application based on the condition that they develop a CRA compliance plan. Over the next six years, however, the bank failed to make a single mortgage loan in the City of Gary. In 1986, Bank of Indiana was acquired by Bank One, which also had made no mortgage loans in black neighborhoods of Columbus in previous years. A CRA protest between Bank One and three cities finally settled the matter. Bank One signed a \$30 million CRA agreement in Gary. In 1987, for the first year ever, Bank One made millions of dollars in home loans in Gary. Remarkably, when the Federal Reserve Board had approved Bank One's application over widespread community protest, they asserted that the lack of home loans to inner-city areas was due to "lack of demand."

CRA agreements have succeeded where conditional approvals have failed because they measure CRA compliance by the only thing that counts: actually making loans. In 1984, for example, three Chicago banks wisely headed off a CRA protest by agreeing to lend \$153 million to inner-city areas. The banks were widely criticized, based on the notion that the agreements would somehow force banks to make unsound loans. Instead, the agreements opened the banks to hundreds of sound lending opportunities. By early 1988, \$80 million in loans were made. Remarkably, these banks' loans to lower-income multi-family housing



jumped from zero in 1983 to over \$35 million by 1988. Most important, not one of these loans has gone into default.

Since 1984, NTIC has assisted community groups in developing over \$1 billion in sound lending partnerships with over 50 financial institutions. All told, the Hubert Humphrey Institute estimates that CRA has led to over \$4 billion in loans for inner-city areas. Yet the regulators have steadfastly refused to require banks to lend a single penny for inner cities.

As I stated earlier, the promise of CRA has been fulfilled, but it has been fulfilled only by community groups and the relatively small number of banks that agreed to join into partnerships. Ten years ago, I would never have guessed that community groups would have to enforce CRA themselves. While the regulators have been rescuing banks from a self-created Black Hole of Big Oil and loan speculation, community groups have steadily guided banks into billions of dollars in sound loans in inner-city areas. No lender has complained about the loans they made under CRA agreements. In fact, they are proud of them. NTIC has even convinced the American Bankers Association to stop fighting CRA and start publicizing the countless successes that have followed from CRA agreements.

Despite notable successes, we have only scratched the surface of what financial institutions can do to turn around housing and job loss in inner-city areas. I have to stress that the increasing number of CRA partnerships has occurred not because of tough regulation, but despite weak regulation. The number of lenders that have undertaken aggressive CRA efforts is very small compared to the number that would if regulators gave them failing CRA grades and turned applications

down. At best, the CRA process has forced some lenders to open their boardroom doors to community people. Once inside, the neighborhoods have to open the bankers' minds by themselves. Many lenders simply refuse to discuss any substantive efforts to improve CRA compliance. Attached to my testimony is a letter from one bank in Tennessee that typifies many lenders attitude toward CRA. The bank only provided a copy of their CRA Statement after four written requests. The bank also stated that further requests for information they are legally required to disclose would only be met after consultation with legal counsel. When attitudes like these emerge, the typical response of regulators can be summarized in four words: approve protested applications now. In fact, the regulators are now refusing to grant brief delays in the CRA comment process so that community groups can document redlining and attempt to head off a CRA protest by privately discussing their concerns with lenders. In Chicago, for example, some well-timed comment period extensions by the Federal Reserve Board in 1984 helped establish an orderly negotiation process between banks and community groups that stopped any CRA protest. Those days are over. Instead of denying banking applications, the regulators are now denying due process to citizens by requiring them to file a CRA protest almost as soon as they learn an application is submitted.

Moving into its second decade, the CRA promise to end redlining is at a crossroads. From San Antonio to Duluth, from Miami to Seattle, community groups have conclusively proven two things. First, inner-city neighborhoods need plenty of loans. Second, residents of these neighborhoods can and will repay these loans better than many other borrowers. CRA must become a cornerstone of public-private partnerships to revitalize inner-city America. To fulfill the promise



of CRA, we can no longer approve of banks that lose millions on loans to Mexico and Texaco but won't lend to creditworthy Americans in their own back yard. To fulfill the promise of CRA, we can no longer approve of banks that create their own tiny community development corporations to clean up the mess they created by closing inner-city branches long ago. To fulfill the promise of CRA, we can no longer accept regulators that explain away redlining as "lack of demand," even though every lender that has signed a CRA agreement has immediately been deluged with sound loan applications.

While some bankers are getting the message, most regulators are not. Congressional action is needed to ensure that the promise of CRA is fulfilled in its second decade. NTIC requests the following steps, most of which have already been drafted into pending Congressional legislation:

- o Expand HMDA to include geographic disclosure of commercial loans. Chicago lenders already provide this data at minimal cost. Commercial loan disclosure can do for economic development what HMDA has already begun to do for inner-city housing development.
- o Revamp the CRA grading system. A "3" rating should represent average, and no more than one out of four lenders should get above average grades. Only those lenders with above average ratings should be permitted to engage in new banking powers such as interstate banking.
- o Require public disclosure of CRA ratings and written CRA evaluations by regulators.

- o Revise comment period procedures so that citizens are guaranteed due process. When substantive CRA issues are raised by commenting parties, these comment periods should automatically be extended by at least a month.

Congress must also keep its own end of the promise to inner-city America. CRA partnerships have provided excellent leverage for federal grants and loans. In Chicago, our CRA partnerships have created over 2,000 units of new low-income rental housing, typically using two private dollars for every \$1 in public funds. However, these partnerships can not provide leverage where government funds are not available at all. The Community Development Block Grant (CDBG) program should be doubled, from \$3 to \$6 billion. Targeting of CDBG funds to lower-income neighborhoods should be increased from 60 percent to 100 percent. And a modest increase in federal housing subsidies will not break the national budget. For example, small upfront subsidies for low-income rental housing can make projects feasible without locking the federal government into long-term debt service subsidies.

Finally, the promise to end redlining can only be fulfilled when other actors in the home lending process share the goals embodied in CRA. Lenders won't make inner-city loans when the secondary market won't buy them and the mortgage insurance companies won't insure them.

In the past several years, Fannie Mae, Freddie Mac, and the MI companies have enormously tightened criteria that affect borrowers in inner-city America. For example, after redlining hearings before the Senate Banking Committee in 1977, Fannie Mae and Freddie Mac totally revised standards on redlining, zoning, neighborhood conformity, borrower analysis, and downpayment requirements. These

changes opened up housing credit for inner-city neighborhoods across the country. By 1985, however, almost every piece of anti-redlining language was dropped from these agencies' selling guides. Just when lenders were starting to reinvest, Fannie Mae and Freddie Mac shut off their spigots.

The MI companies have followed suit. The neighborhood analysis standards used by these companies discriminate against inner-city neighborhoods that don't fit the suburban cookie-cutter. Economic life, neighborhood conformity, and zoning are used as proxies for income and race to deny insurance to inner-city areas. Lower-income families that worked hard to save a five percent downpayment are finding it impossible to obtain mortgage insurance.

Fannie Mae and the MI industry are screaming that they have taken a beating in recent years. What they do not say is that their losses have little to do with the risks typically associated with inner-city neighborhoods. A large share of loan losses experienced by these companies can be attributed to the industry's new four letter word: EPIC.

In the early 1980's, for example, David Maxwell, then head of the Ticer Mortgage Insurance Company (TMIC), invested heavily in EPIC's speculative loans. When he was chosen to run Fannie Mae, he tightened loan standards for low-income Americans but opened the door to millions in EPIC loans. As a result, TMIC lost \$224 million in 1986, largely due to a \$166 million exposure to EPIC. Fannie Mae made \$183 million in profits in 1986 despite similarly heavy losses on EPIC loans.

Next to oil patch speculation, the use of unstable mortgage

instruments has also played a heavy role in the losses experienced by Fannie Mae and the MI companies. For example, research of the loss experiences of all MI companies by Moody's shows that 95 percent mortgages with graduated payments, temporary interest buydowns, and negative amortization schedules were five to ten times more likely to default than 95 percent fixed-rate loans. During their worst year, 1 out of 100 fixed-rate mortgages resulted in an insurance claim. However, 9 in 100 interest buydown mortgages resulted in a claim in their worst year. Loss rates for 95 percent fixed-rate loans were the same as loss rates for 90 percent adjustable mortgages, which generally are governed by less stringent lending guidelines. Instead of eliminating mortgage instruments favored by investors that result in "payment shock," the MI companies and Fannie Mae have placed tight requirements on 95 percent fixed-rate loans, which house lower-income Americans and have much lower risk.

The frequently heard claim that 95 percent mortgages present unacceptable risk is hogwash. In fact, historic default rates on 95 percent fixed-rate, conventional mortgages made from 1957 to 1977 are actually lower than default rates on 80 percent mortgages originated in the past decade. The characteristics that created low default rates in the 60's and 70's, even for 95 percent mortgages, are the same characteristics embodied in most CRA partnerships: active lenders; stable mortgage instruments that don't result in "payment shock"; and sound borrowers who aren't gambling on gyrations in real estate values, but are seeking to own a home. The low default rates of the 60's are alive and well in CRA partnerships today. Oddly, these are the very loans that Fannie Mae won't buy and MI companies won't insure.

NTIC has arranged a number of meetings between Fannie Mae and local community groups that have resulted in a better understanding and substantial progress. Fannie Mae has revamped standards on economic life, highest and best use, nonconforming zoning, and neighborhood conformity that will hopefully stop loan rejections in many inner-city neighborhoods. However, crucial changes are needed on issues of borrower creditworthiness. To house inner-city America, Fannie Mae must remove excessive restrictions on purchasing 95 percent, fixed-rate, conventional mortgages. Fannie Mae must also increase their flexibility in purchasing loans that exceed conventional 28-36 debt to income guidelines. Many inner-city residents pay far more than a quarter of their income for housing. Those with good credit histories should be viewed favorably when they apply for a home loan. Finally, in the face of blatant redlining by the MI industry, Fannie Mae's charter should be amended so they can purchase inner-city conventional mortgages with low downpayments without MI insurance, which is currently required.

Freddie Mac has also agreed to restore anti-redlining language they dropped from their earlier selling guides. However, they have been unwilling to stop lending discrimination against sound low-income multi-family housing. In the Northwest Bronx, for example, Freddie Mac has invested in slums that have inoperative elevators while rejecting applications for showcase low-income rental housing developed by non-profit organizations. Down South, a multi-family mortgage application by the South Atlanta Land Trust was rejected by 15 Freddie Mac brokers because it did not meet "investment quality standards." Freddie Mac has stressed that their mission is to "connect Main Street

to Wall Street" through securitization of investment-quality loans. In practice, Freddie Mac has gentrified the end of Main Street while letting the other end turn into a slum because Wall Street doesn't feel comfortable with sound, creatively structured applications to create low-income rental housing.

The MI companies should be singled out for Congressional review, which ultimately should lead to changes in McCarron-Ferguson that would place them under federal regulation. Underwriting guidelines of the MI companies require a major overhaul to stop discrimination against inner cities. The neighborhood analysis standards recently adopted by Fannie Mae should be adopted by the MI companies. Currently, MI standards almost dictate the denial of loans in many inner-city areas, not because they are risky, but because they don't look like suburbs.

Premium rates charged by mortgage insurers should be federally regulated. From 1985 to 1986, the 12 active MI companies increased profits from \$41 million to \$133 million while actually reducing their volume of new policies written by almost 20 percent. The industry is using the hype of bad oil patch loans to drastically increase rates, post record profits, and increase discrimination against inner-city neighborhoods with low risk.

Finally, the MI companies must stop discriminating against the millions of lower-income Americans who can only afford a 5 percent downpayment on a conventional mortgage. From 1985 to 1986, the MI's share of total mortgage originations dropped from 20.4 percent to 11.78 percent. FHA's share increased from only 11.2 percent to 13.2 percent. These figures seem to confirm our direct experience: many lower-income borrowers are being squeezed out of the housing market

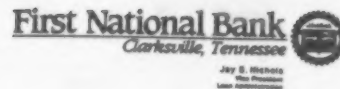
entirely because insurance on low downpayment mortgages simply became impossible to obtain.

Fulfilling the promise of CRA requires coordination and regulation of an increasingly complex housing finance system. Tough regulation means that lenders will originate sound inner-city loans that can be purchased by Fannie Mae and insured by MI companies. Instead, the regulators, lenders, and insurers are reinforcing each others discriminatory practices and trying to place the blame for our housing crisis on each other. Ultimately, the blame is placed on the victim: sound inner-city applicants who are just not sound enough to meet arbitrary lending standards that bear little relation to real risk.

In conclusion, I'd like to point out that for all the wisdom of the lenders and all the risks of inner-city neighborhoods, we've done far better than the banking and MI industry in one crucial area: survival. Like hundreds of other lenders, the old Continental Bank learned the lessons of energy speculation and Third World investment the hard way: they died. Our neighborhoods survived to see a new Continental Bank begin to reinvest soundly in Chicago. Tigor Mortgage Insurance Company led in industry profits back in 1982 when the MI companies were lured to Texas by speculative real estate with rapidly appreciating values. TMIC learned that what comes up often comes down just as quickly. While TMIC took the plunge, others found a haven of stability in inner-city neighborhoods that nudged slightly ahead through self-revitalization efforts. Investor greed is a poor substitute for meeting neighborhoods' credit needs. If ten years of CRA have proven anything, it's that inner-city neighborhoods deserve a

chance. Not because it's the right thing to do, but because it's the profitable thing to do. Once again, I'd like to thank the Committee for sending that message to a banking industry that often does not understand its own best self-interest.





## 1986 Reinvestment Round-Up

October 27, 1987

Mr. Walter Frierson  
P.O. Box 28  
Columbia, TN 38401

Dear Mr. Frierson:

In order to bring our correspondence with you to a permanent conclusion, I am enclosing a copy of our latest CRA Statement that you requested. Be advised, however, that any and all future requests from you for any facts, figures, or information from or about this bank must be presented to me in person in my office at this bank by you. I will require appropriate proof positive as to your identity in the event of such a presentation and I reserve the right to defer any and all such requests to legal counsel for determination of their validity and appropriateness.

Sincerely,

*Jay S. Nichols*  
Jay S. Nichols  
Vice President

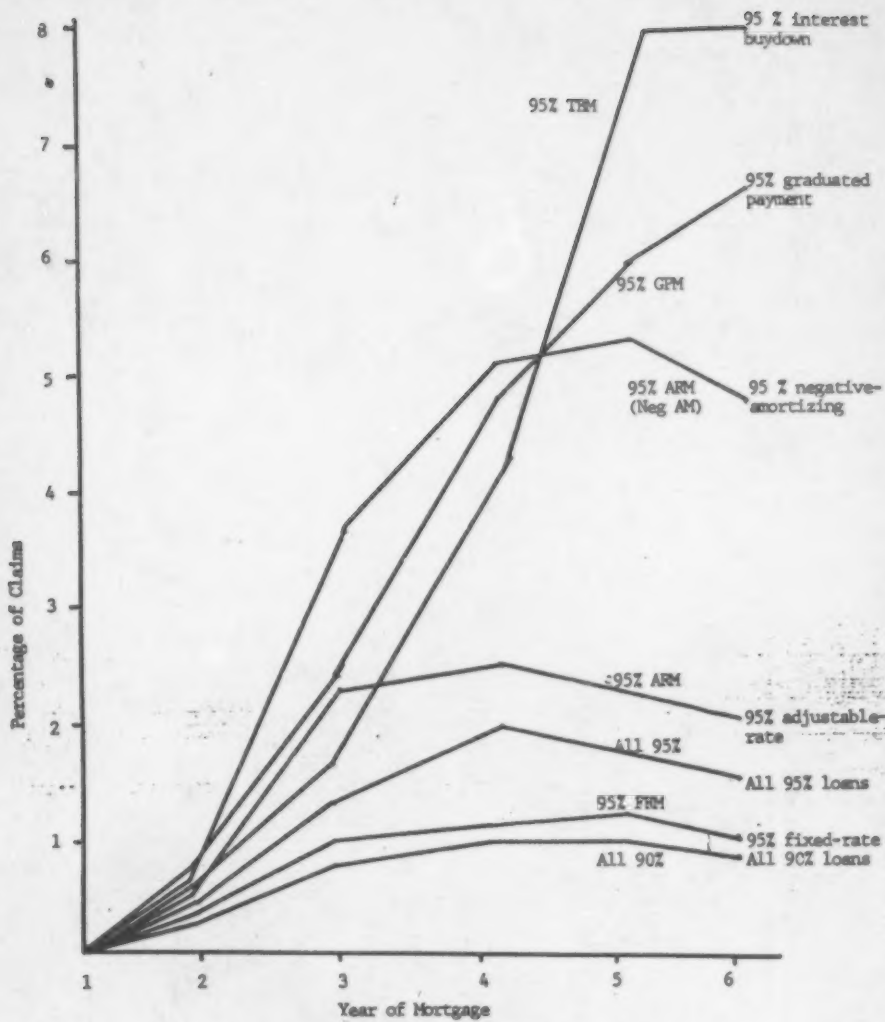
snb

enclosure

Technical assistance from the National Training and Information Center helped communities across the nation bring almost half a billion dollars in reinvestment to their neighborhoods. Commitments reflect agreements to lend for home improvement, mortgage and small business credit needs.

| AREA             | BANK                            | COMMITMENT      |
|------------------|---------------------------------|-----------------|
| California       | Wells Fargo Bank                | \$50 million    |
| Hartford, CT     | United Bank and Trust           | \$3 million     |
| New Britain, CT  | New Britain National Bank       | \$1 million     |
| Jacksonville, FL | Barnett Bank                    | \$50 million    |
| Waterloo, IA     | Waterloo Savings Bank           | \$5 million     |
| Chicago, IL      | Continental Bank of Illinois    | \$25 million    |
| Chicago, IL      | Bank of Edgewater               | \$12 million    |
| Indianapolis, IN | American Fletcher National Bank | \$30 million    |
| Gary, IN         | Banc One, Merrillville          | \$25 million    |
| St. Louis, MO    | Landmark Bank                   | \$6 million     |
| St. Louis, MO    | South Side National Bank        | \$7 million     |
| Duluth, MN       | First Bank of Duluth            | \$4 million     |
| New Jersey       | Midlantic Bank                  | \$11 million    |
| Columbus, OH     | Banc One, Columbus              | \$50 million    |
| Philadelphia, PA | Fidelity Bank                   | \$50 million    |
| Philadelphia, PA | Continental Bank                | \$10 million    |
| Providence, RI   | Fleet Bank                      | \$8.6 million   |
| Memphis, TN      | First Tennessee Bank            | \$4.5 million   |
| San Antonio, TX  | National Bank of Commerce       | \$5 million     |
| Milwaukee, WI    | Marshall and Ilsley Bank        | \$50 million    |
| Milwaukee, WI    | Marine Bank                     | \$31 million    |
| 17 CITIES        | 20 BANKS                        | \$427.3 Million |





CLAIMS EXPERIENCES OF ALL MI COMPANIES FOR  
MORTGAGE BOOKS OF BUSINESS BY YEAR 78-86

Source: Moody's Structured Report on MI Industry

## From protests to partnerships

*Tension is easing as three Chicago banks reinvest in communities targeted by local community action groups*

**C**onfrontations between community action groups and banks seeking to expand are no longer isolated incidents. The groups typically attempt to block approval of a merger or acquisition on grounds that a bank is not in compliance with the Community Reinvestment Act. Their goal is to obtain commitments from banks to lend to low- and moderate-income neighborhoods.

Community groups don't have to be enemies of banks. In Chicago, for example, bankers and community groups are

working as partners—with productive results. "The Chicago story is a very positive one," says Perry Pero, an executive vice-president in charge of credit policy for Northern Trust Co.

Pero's bank agreed to commit \$18 million over five years to commercial and residential loans in Chicago's low- and moderate-income areas. In the first two-and-a-half years, reports Pero, the bank has lent over \$11 million. Not one of the loans is in default, and no borrower has

even missed a payment.

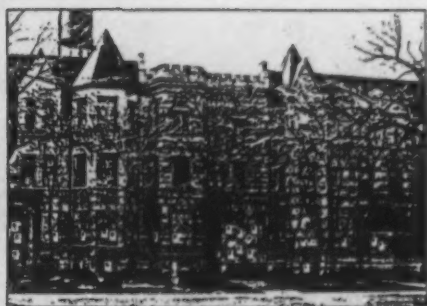
A pleasant surprise is that the relationship between the community groups and bankers—historically a tense one—is growing into a partnership. "Our successful program has created a great deal of mutual respect," says Pero. Similar effects have been seen at two other large Chicago banks, First National Bank and Harris Bank & Trust Co., which also are participating in the community partnership.

**Expansion protest.** The current Chicago program began in 1984, when all three banks were involved in expansion or merger efforts. First Chicago was looking to acquire American National Corp., a Chicago bank holding company. Bank of Montreal was trying to acquire Harris Bancorp, and Northern Trust had applied to set up a Florida-based bank holding company.

The three banks were approached by the Community Reinvestment Alliance, which comprises local community groups. The Alliance was protesting the banks' compliance with the Community Reinvestment Act. The banks negotiated agreements with the groups and committed a total of \$173 million over five



**THREE CHICAGO BANKS** are working as partners with community groups. Here, Barry Sullivan, CEO of First Chicago Corp., announces a \$100 million reinvestment program. Seated between Robert Lucas (left), president, Rehab Network, and Richard Hartnack, senior vice president, First Chicago, is Gale Cincotta, executive director of NTIC, the group that spearheaded the agreements.



"BEFORE" AND "AFTER" photographs show the dramatic improvement that reinvestment programs can bring about. The build-



ing above is one of many in Chicago that have been rehabilitated under a special bank lending program.

years for loans to low- and moderate-income areas. First Chicago led the way with a \$100 million commitment.

The agreements between the banks and the Community Reinvestment Alliance are not contracts per se, states one banker, but rather living documents subject to mutually agreed changes. Basically guidelines for each bank, the agreements define loan categories and loan processing procedures.

The loans target those neighborhoods where the median household income is 75% or less than the median income of the Chicago metropolitan area. Loan categories include commercial and industrial, multifamily, residential co-op, mixed use, single family, and home improvement loans. The majority of the loans are for multifamily dwellings.

**Pricing.** As a general statement, the loans in the program are priced below market, but not below cost of funds. Richard C. Hartnack, senior vice-president at First Chicago, explains how the pricing works at his bank. Loans are floating rate for the most part with maturities between 20 and 30 years. Repricing is on a 1, 3, or 5-year basis.

Rates for loans in the program are pegged to First Chicago's posted market rates, says Hartnack, adjusted up a bit usually, but without any points. The absence of points is what brings the overall pricing below market rates.

Are the loans profitable?

"We know they're not profitable at present if all operating costs are included. But because of the credit quality and the length of the loans, we feel eventually we'll cover our operating costs," Hartnack says.

**Packaging help.** As part of the program, the banks also agreed to contribute money to community groups that do

loan packaging, to help pay for technical assistance. Loan packagers screen potential borrowers and help assemble documentation.

According to Bruce Gottschall, executive director of Neighborhood Housing Services of Chicago, Inc., packagers are trained to know what documentation banks require from borrowers. NHS is one of the largest groups in the Community Reinvestment Alliance and one of the most active loan packagers. "We try to make sure all the bank's questions are answered before they're asked," says Gottschall.

Edward J. Williams, senior vice-president of the Consumer Banking Group at Harris Trust, explains that the packagers serve as a point of entry for loan applicants. Packagers help to minimize processing expense to the bank. They also help market and promote the loan programs through block meetings, fliers, and street signs.

**Review boards.** The agreements outline the establishment of a review board for each bank involved in the program. The boards, which meet quarterly, comprise five members from the community groups and five officers of the bank. The main functions of the boards are to review the progress of each bank's program and to reexamine allocation of funds in the different loan categories.

The one point in the agreements that bankers would not negotiate was credit standards. "These loans have to be made like any other loans," says Williams of Harris Trust. "We expect them to be paid in a reasonable and timely fashion." Northern's Pero confirms that "the underwriting standards have to be within the bounds of prudent banking."

**Resistance.** The relationship between bankers and community groups has not

been perfect, but it is improving, both bankers and activists insist.

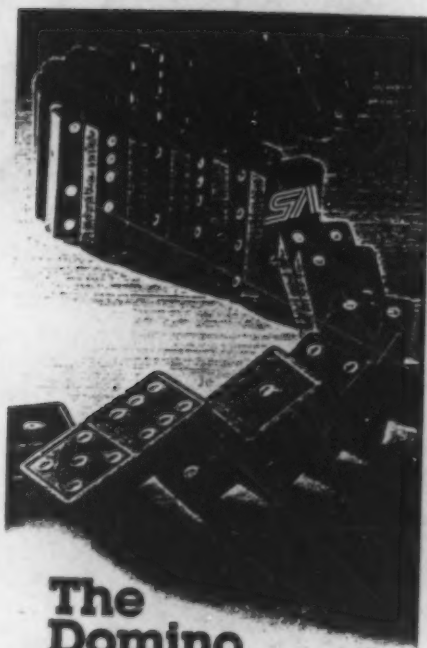
Banks have two main reservations about cooperating with community groups. First, banks feel their compliance with the Community Reinvestment Act is being challenged unnecessarily. Second, they feel that community groups' approach, at least initially, is overly confrontational.

In brief, the Community Reinvestment Act stipulates that banks must define their service area, report their efforts to help meet community needs for credit and services, and make particular lending data available to the public. The act does not set specific loan amounts or criteria for compliance.

"This law requires us to be very proactive," says Harris's Ed Williams. The bank has to interpret the act, set its own guidelines, and prove that its interpretation is in compliance.

**Point, counterpoint.** All three banks involved in the Chicago program insist they had complied with the law long before they entered into agreements with community groups. "We had no concerns about being in compliance with CRA. We knew we would pass the examinations," says Williams. He adds, "Initially, I was somewhat aggravated with the challenge. I felt we were doing a reasonable job in the community."

Gale Cincotta sees things differently. Cincotta is the executive director of the National Training and Information Center, a consulting concern that trains community groups to negotiate with banks and other organizations. She is also chairperson of National People's Action, a coalition of community groups. Cincotta was at the forefront of negotiating the Chicago agreements. The banks, she feels, were not in compliance with



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CRA because they were not doing a sufficient job of lending to certain Chicago neighborhoods. Cincotta maintains that in their CRA reports, banks often include philanthropic grants as examples of compliance with the act. "CRA means hard dollar loans, not grants," she says. Two years after the lending agreements went into effect, however, she acknowledges the banks are doing a better job.

**Inner fighting.** For their part, bankers fault the community groups for being needlessly confrontational.

Williams points out that Harris first received notice of a protest in a telegram stating the community groups' demands. "They didn't ask if we wanted to sit down and discuss these issues. They simply made their demands," he says.

"I see it as the way we have to do business," retorts Cincotta. Community groups do not have the resources to hire negotiators and lawyers, so their approach may appear more confrontational than bankers are used to.

The relationship changed quickly after the first week of negotiations, Williams recalls. "The community groups began to understand we were earnest," he says.

As a matter of fact, Hartnack says, his chairman, Barry Sullivan, commented after hearing the groups' case that the issue merited attention. "He saw that the common sense test was not being met. Nobody was lending to virtually an entire segment of the Chicago real estate market—existing multifamily units," says Hartnack.

**Cooperation grows.** Cincotta points out that CRA protests have been toned down lately. "As word about the positive programs gets out," says Tom Schraw, an NTIC organizer, "we've found that banks are becoming more cooperative. We want to continue in that direction."

Communication is important. "My advice to bankers who receive a CRA protest," says Williams, "is to invite the protestors in to talk. Nothing can be gained by ignoring the challenge. It's not going to go away."

Bankers may fear that negotiating with community groups would force them to make bad loans. Cincotta maintains that's not the case. A poor lending record would defeat community groups' goals, she says.

These goals include getting banks to lend to low- and moderate-income areas and to help revitalize the neighborhoods. "The short-term goal is to get capital into the neighborhoods," says Cincotta. Eventually, she hopes, banks will make the programs a regular part of their business and be able to offer the loans at market rates.

**Good performance.** So far, the programs seem to be on their way to achieving the early goals. As of April 1987, loan activity of the three Chicago banks under the neighborhood revitalization program totaled \$52.3 million, with \$30.1 million going to multifamily housing loans. Over 2,000 rental units have been rehabilitated under the program.

Banks reject far fewer applications than expected. And Pero indicates "the loans are performing exceedingly well."

The program with the three big banks has had a ripple effect on Chicago neighborhoods, reports NTIC's Schraw. In 1982, he says, the aggregate amount of mortgage loans originated by all financial institutions for multifamily housing in Chicago's low- and moderate-income census tracts was \$17.3 million. By 1985, when the program first came up to speed, that figure had jumped to \$33.8 million, a 196% increase.

The loan programs, concludes Northern's Pero, have been "very satisfactory for the bank." □

# NTIC National Training and Information Center

964 West Washington Boulevard □ Chicago, Illinois 60607 □ (312) 243-3035

## 1987 REINVESTMENT ROUND-UP

The National Training and Information Center provided technical assistance to community groups in the following areas in developing new reinvestment partnerships in 1987.

| Area               | Bank                   | Commitment   |
|--------------------|------------------------|--------------|
| San Antonio, TX    | Republic Bank          | \$ 5 million |
| San Antonio, TX    | Texas Commerce Bank    | 5 million    |
| San Antonio, TX    | M Bank                 | 5 million    |
| Memphis, TN        | Union Planters Bank    | 7 million    |
| Syracuse, NY       | Key Bank               | 5.3 million  |
| Des Moines, IA     | Valley National Bank   | 2.6 million  |
| Davenport, IA      | First Bank             | 0.5 million  |
| Council Bluffs, IA | Council Bluffs Savings | 7.3 million  |
| Dubuque, IA        | Key City Bank          | 0.6 million  |
| Waterloo, IA       | Cedar Falls Trust      | 0.5 million  |
| New York, NY       | Chemical Bank          | 25 million   |
| Chicago, IL        | Austin Bank            | 6 million    |
| Indianapolis, IN   | Bank One, Indianapolis | 30 million   |
| Atlanta, GA        | Sun Trust              | 25 million   |
| Washington, D.C.   | Riggs Bank             | 40 million   |
| Nashville, TN      | Sovran Bank            | 43 million   |
| Lexington, KY      | First Security Bank    | 20 million   |

44

TOTAL REINVESTMENT 248.2 MILLION

### Results since 1984:

|       |                 |               |
|-------|-----------------|---------------|
| 1984  | \$172.1 million | 7 agreements  |
| 1985  | 108.3 million   | 6 agreements  |
| 1986  | 297.3 million   | 20 agreements |
| 1987  | 248.2 million   | 18 agreements |
| TOTAL | 825.9 MILLION   | 51 AGREEMENTS |



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TABLE 1

THREE YEAR LENDING ACTIVITY UNDER NEIGHBORHOOD LENDING PROGRAMS  
 (FIRST NATIONAL BANK OF CHICAGO, HARRIS BANK, NORTHERN TRUST) \*

| Type of loan                                           | Amount of loans | Number of loans |
|--------------------------------------------------------|-----------------|-----------------|
| Single-family mortgage                                 | \$ 6,379,000    | 70              |
| Multi-family mortgage                                  | 37,490,000      | 148             |
| Home improvement                                       | 1,267,000       | 91              |
| Mixed-use                                              | 7,649,000       | 48              |
| Commercial                                             | 19,983,000      | 60              |
|                                                        | \$ 72,768,000   | 417             |
| Home improvement loans by Continental Bank (1987 only) | 2,132,974       | 167             |
| Total                                                  | \$ 74,900,974   | 584             |

\* Loans made under neighborhood lending programs as of October 1987. First loans were made in October 1984.

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TABLE 2

DISTRIBUTION OF MORTGAGE LOANS TO CHICAGO CENSUS TRACTS BY FIRST  
 NATIONAL BANK OF CHICAGO, HARRIS BANK, AND NORTHERN TRUST

(IN THOUSANDS)

| Census Tract        | 1982-1983 |                  | 1985-1986  |                  |                  |
|---------------------|-----------|------------------|------------|------------------|------------------|
|                     | Amount    | Percent of Total | Amount     | Percent of Total | Percent Increase |
| Low/Moderate Income | \$ 10,323 | 14               | \$ 35,077  | 23               | 239              |
| Middle Income       | 21,153    | 30               | 50,622     | 34               | 139              |
| Upper Income        | 40,176    | 56               | 64,701     | 43               | 61               |
|                     | \$ 71,652 | 100              | \$ 150,400 | 100              |                  |

Based on single-family and multi-family mortgage loans reported in annual Home Mortgage Disclosure Act reports.

Definitions:

Low/moderate income: census tracts with median income less than 80 percent of median income for Chicago MSA

Middle income: census tracts with median income from 80 to 120 percent of median income for Chicago MSA

Upper income: census tracts with median income over 120 percent of median income for Chicago MSA

1984 data excluded because it was transitional year. First loans in October 1984.

# Chicago Tribune

## Fine print offers weapon against redlining

By Stanley Ziemba

Urban affairs writer

A little-noticed clause in a new federal housing act has provided cash-starved inner-city neighborhoods in Chicago with an improved weapon for battling discriminatory redlining in home-mortgage lending.

Among dozens of provisions in the 1987 Housing and Community Development Act signed into law earlier this month by President Reagan, the clause generally escaped notice in the hoopla surrounding enactment of the nation's first housing legislation in seven years.

But, as it applies to Chicago and other U.S. cities, the clause makes permanent the anti-redlining federal Home Mortgage Disclosure Act. The measure was first enacted in 1975 with a five-year "sunset" provision, which meant that housing groups were forced to lobby Congress to reauthorize it every time it was scheduled to expire. Now they will no longer have to do so.

In addition, the new federal act strengthens the original disclosure legislation, so certain mortgage banks as well as traditional banks and savings and loans are now required to disclose where they make housing loans. Originally, the Home Mortgage Disclosure Act applied only to banks and savings and loans. Section 565 of

the new housing act also requires mortgage companies owned by banks and thrifts to disclose their lending activities.

The new rule, according to neighborhood housing activists, should stop a growing tendency among some banks and thrifts to originate home loans through their mortgage company subsidiaries to hide redlining.

Redlining is a practice by which financial institutions "write off" certain neighborhoods as bad risks or unworthy of credit. As a result, loans for homes in those areas are difficult or impossible to obtain.

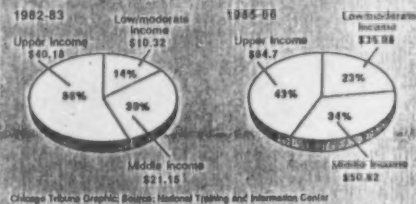
"The permanent enactment and strengthening of the Home Mortgage Disclosure Act is a watershed victory for community groups fighting to save their neighborhoods from redlining," said Gale Cincotta, executive director of the National Training and Information Center.

Cincotta's organization, a Chicago-based neighborhood advocacy group, led the fight in the early 1970s for enactment of the disclosure law. The group continued to lobby Congress when the law's sunset provisions were about to take effect and succeeded in keeping the act on the books despite opposition from the clout-heavy American Bankers Association. Cincotta said the bankers' group wanted the disclosure act abolished.

### Mortgage loans in Chicago

By First National Bank of Chicago, Harris Bank and Northern Trust

In millions of dollars lent by income level of Chicago census tracts, before and after 1984 formation of lending pool



By making the act permanent, housing groups and bankers can now concentrate their efforts on combating inner-city neighborhood housing deterioration and abandonment, Cincotta said.

The disclosure law does not force financial institutions to stop redlining but requires banks and thrifts to disclose how many loans they make, and the total dollar amount of the loans, in each census tract of a metropolitan area. The information becomes a powerful tool for inner-city neighborhood groups to keep financial in-

stitutions from redlining their communities.

In Chicago, the act "has led to marked increases in lending to low-income neighborhoods by many of Chicago's largest banks," Cincotta said.

For example, Cincotta credits pressure from the Chicago Reinvestment Alliance, a coalition of community groups led by the National Training and Information Center, for bringing about an agreement by three banks to set up a loan pool for lower-income neighborhoods. Under the agree-

ment in 1984, First National Bank of Chicago, Harris Bank and Northern Trust Bank set up a \$153 million pool of money for housing and business loans for the city's lower-income census tracts.

To date, 417 loans totaling nearly \$73 million have been made from the pool of funds, including \$37.5 million for upgrading more than 2,000 low- to moderate-income multifamily housing units in the city's lower-income census tracts, Cincotta said.

By contrast, in 1982 and 1983, two years before the lending pool was established, the three Chicago banks made a total of only \$10.3 million in housing loans in the city's lower-income census tracts, according to a study by Cincotta's organization.

In 1985 and 1986, the two years following establishment of the lending pool, the total amount of loans by the three banks within the city's lower-income census tracts increased to \$35 million, or 23 percent of their total home loans within the city, the study found.

By using the anti-redlining disclosure law as a negotiating tool, Cincotta's group and the Chicago Reinvestment Alliance also got Chicago's Continental Bank in 1986 to set aside \$25 million for low-interest home-improvement loans in the city's low- to moderate-income neighborhoods.

The CHAIRMAN. Thank you for some useful information, Ms. Cincotta. We deeply appreciate it.

Our next witness is Tony Reyes, mayor of the city of San Luis, AZ. Mayor, I understand you've done a lot of good hard constructive positive work on sweat equity and that you have a fine and ambitious record of trying to get more credit for people who are willing to do the work themselves with their own operations. Go right ahead, sir.

**STATEMENT OF TONY REYES, MAYOR, SAN LUIS, AZ**

Mr. REYES. Thank you, sir.

First of all, spoken like a true politician, when I found out I only had 3 to 5 minutes to make a statement here, I almost refused to come. That's really tough on us out here. [Laughter.]

Let me just begin by thanking you, Senator, and the committee for allowing me the opportunity to present testimony regarding the Community Reinvestment Act and the banking system, which of course includes involvement by the Federal Reserve Board and their staff.

[The complete prepared statement of Marco A. Reyes follows:]



## Town of San Luis

POST OFFICE BOX 8  
88021 FIRST STREET  
SAN LUIS, ARIZONA 86340-0489  
908/827-8143 • 908/827-8888

OFFICERS  
JOHN G. SOLARZ  
Town Manager/Clerk

### TOWN COUNCIL

MARCO ANTONIO REYES, Mayor  
LUIS CASTRO, Vice Mayor

EMILIO S. ARRIOLA, Member  
BENI VIGIL, Member  
GEORGE GUERRERO, Member  
SILVIO F. FLORES, Member  
JESUSITA RODRIGUEZ, Member

March 23, 1988

Senator William Proxmire  
United States Senate  
Committee On Banking, Housing and  
Urban Affairs  
Washington, DC 20510-6075

RE: Testimony given to the Senate by Mayor Marco A. Reyes, San Luis  
Arizona.

### Senators:

Thank you for the opportunity to present this relevant testimony regarding  
the Community Reinvestment Act (CRA) and the Banking system which of course  
includes involvement by the Federal Reserve Board and their staff.

I am the Executive Director of the Comité de Bienestar, a non-profit  
community corporation, founded in 1981. This agency is dedicated to  
creating housing opportunities for low and medium income families.  
We have provided 445 farmworker families with a piece of land they can  
call their own and currently are helping them build their homes and to  
actively participate in community affairs as they become residents.  
Also, as a Mayor of the Town of San Luis for the last 3 1/2 years, I have  
seen the problems and advantages of dealing with our local banking  
institutions and must state that at present the disadvantages to our  
rural community outweigh the advantages.

While our local bank has over 40 million in deposits, it does not seem  
to have the flexibility to provide an adequate range of services to our  
predominantly low and medium income residents. Even though the CRA  
provides guidelines for the banking system to provide mortgage loans,  
home improvement loans and community development loans, there is no  
mechanism set up within that system by the Federal Reserve Board or  
monitoring by them to insure that the banks can and do provide adequate  
services to rural low and medium income residents within Arizona.

Using our community as an example, we have helped more than 120 farmworkers  
build homes. Of those only two (2) were given regular mortgage loans.  
Some of the others were denied mortgages because they are seasonal farm-  
workers and do not work three months per year. I suggest to you that  
there are other professions that are just as seasonal as farmwork such  
as teaching. However, teachers do not seem to have the problem of a  
break in employment in qualifying for loans. Other seasonal farmworkers  
were told by the bank to finish paying for their land and then they  
were issued a mastercard by the bank at the 19 and 21 percent interest  
rate to complete their homes. Furthermore, there is no mortgage loan  
officer stationed at our local bank.

I give this as only one example of how the banking system and the  
monitoring of the CRA is not working in the rural communities. I suggest  
that their are other creative ways of financing and providing mortgages  
to low and medium income families and it is the responsibility of the  
bank and the Federal Reserve Board to create other options.

The Comité de Bienestar, itself, has had difficulty in securing appropriate  
loans from the banking system. The farmworkers members initially raised  
over \$100,000 towards the purchase of the land and raised additional funds  
towards the development of the land before the banking system would lend  
us development monies. In order to secure our first two loans, we had  
to put up twice the amount of collateral. To receive \$400,000 we had to  
put up the whole project, which at that time was valued at about \$800,000.

The intent of the CRA is to help communities, organizations, and people  
such as us build and grow, the intent is not to redline our efforts.  
It was out of necessity that we joined with several other concerned  
rural community groups, including PFEF Housing Development Corporation  
(PHDC) which has provided us technical assistance, in protesting the bank's  
acquisition of another bank because our community and its people were not  
being adequately served. Prior to the protest, meetings were held with  
the bank over a six month period of time which did not produce any  
agreements which would benefit the rural communities. The response by the  
Federal system and the bank was not what we expected. Because we filed  
a complaint, we were immediately seen as adversaries in some respects by  
both the bank and the Federal agency.

While the bank agreed to meet with us and everyone was in agreement on  
the time, place, and agenda, the Federal Reserve representative attempted  
to unilaterally change all three. As a result on September 1st when the  
rural community groups, PHDC, and Valley National Bank held a meeting the  
Federal Representative had already alienated the Bank against the group,  
changed the time of the meeting and tried to impose his own agenda.

A subsequent meeting was scheduled for the following week in Phoenix at  
the Valley National Bank Headquarters. However, we were later informed  
that such a meeting was not necessary and that they would await the  
Federal Reserve Board's decision on the acquisition of the Bank.

The frustration that ensued in Arizona generated a great deal of public  
concern (see the addendum, with correspondence, video tape, and articles  
about the effects of the lack of investment capital in rural Arizona. Sub-  
sequent to these events both the Arizona Congressional and even Alan  
Greenspan have advocated that the Federal Reserve Board staff arrange a  
meeting between PHDC, rural community groups, and Valley National Bank.

To date the Federal Reserve Board has not made any attempts to comply with these requests.

Positive steps have been taken in Arizona to avoid future confrontations by setting up the Arizona Banking Advisory Council by the rural community groups and PHDC. Forty-five banks and savings and loans have been invited to participate in an annual conference on making the CRA work for both the lending institutions and the rural communities..

The workshop which will be held in late April will focus on the investment opportunities in rural Arizona and the formation of a Community Dev. Corporation (CDC). The Community Development Corporation which is to be housed at PHDC will provide technical assistance to Arizona's rural towns in packaging viable projects for financing and marketing them to the banks. The Arizona Banking Advisory Council along with PHDC will provide funding for both annual CRA workshop and the CDC. All of the above was carefully coordinated without the help of the federal representatives because of the fear of negative impacts. We are actually doing part of their job.

Finally, it is our sincere desire that your committee examine the effectiveness of the enforcement of the CRA of 1977 by the Federal Reserve Board in order to avoid the loss of public confidence in the important decisions made by the Congress that affect the very economic survival of rural America.

Submitted by,

Marco Antonio Reyes  
TOWN OF SAN LUIS, ARIZONA

cc: AS Congressional Delegation  
Dr. John D. Arnold, PHDC

SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS  
JANUARY 19, 1988  
WASHINGTON, DC 20510-2075

United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS  
WASHINGTON, DC 20510-2075

January 19, 1988

The Honorable Alan Greenspan  
Chairman, Board of Governors  
Federal Reserve System  
10th and Constitution Avenue, N.W.  
Washington, D.C. 20551

Dear Mr. Chairman:

Recently, the Federal Reserve Board approved the purchase by Valley National Bank, based in Phoenix, of California Valley Bank, based in Fresno, California.

As the Board considered this acquisition, the PFEP Housing Development Corporation lodged a protest claiming that Valley had failed to keep its obligations under the Community Reinvestment Act.

As I understand it, this conflict prompted a good deal of antagonism: public protests by the PFEP angered the bank; PFEP felt the bank would not talk with its officials; and PFEP complained that Fed officials were siding with the bank.

Without addressing the merits of any of these complaints, may I suggest that the Fed could take an affirmative role in bringing peace to this still unsettled environment. Specifically, it seems wise for Fed officials to call a meeting with Valley and PFEP officials (as well as another other interest community groups).

I think it is crucial that the Fed be seen as facilitator of progressive discussion.

Your attention to this request is appreciated.

Sincerely,

William Proxmire  
Chairman

cc: Tim Creedon, Valley National  
John Arnold, PFEP

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## HOUSING DEVELOPMENT CORPORATION

806 East 48th Street • Tucson, Arizona 85713 • (602) 323-0373

December 10, 1987

William W. Wiles, Secretary  
Board of Governors of the Federal Reserve System  
20th and Constitution Ave. N.W.  
Washington, D.C. 20551

Re: Reconsideration of the acquisition of the California Valley Bank by Valley National Corporation.

Dear Mr. Wiles:

We are asking for reconsideration of the action taken on November 30, 1987 by the Board of Governors on the above referenced case based on the following:

1. Non-compliance with procedural requirements by the Federal Reserve Bank.
2. Discrimination by the Federal Reserve Bank and Valley National Bank (VNB) against Arizona's minority and rural populations.
3. Inadequate documentation by Valley National Bank to prove that they are in compliance with the Community Reinvestment Act (CRA).

On October 23, 1987, FHDC Housing Development Corporation (FHDC) wrote to you requesting an extension on the above referenced decision until we were supplied with the complete response document submitted to you by Valley National Bank on October 14, 1987 and had sufficient time to submit a reply. (See attachment A) On October 23, 1987, we wrote to Mr. Ken Rinning of the San Francisco office requesting certain information. (See attachment B) To date we have not received a response to that letter. However, on December 1, 1987, one day after the Board's decision, we did receive all but one page of Valley National Bank's October 14, 1987 submission from Ms Pamela Nardolilli of your legal office which was part of the request in our letter to Mr. Rinning. Obviously the decision was made without our remarks.



Alan Sanchez  
V.D. Artist

Housing Director  
Thomas Martinelli

"DEDICATED TO IMPROVING THE QUALITY OF RURAL HOUSING IN ARIZONA"

There is a non-compliance issue by the Federal Reserve Board with the Rules of Procedure, Section 262.3(c), "The Board will consider the applicant's response only if it is in writing and sent to the Secretary of the Board on or before the tenth day after the date of the letter by which it is forwarded to the applicant." FHDC contends that Valley National Bank was given more than 30 days to respond. Therefore, the Board should not have considered their response of October 14, 1987 when making the decision on this issue. The only allowable admissible response was Valley Bank's original 5 page submittal in August 1987.

FHDC also contends that there is a non-compliance issue by the Federal Reserve Board with the Rules of Procedure, Section 262.3, (3). "In any case in which a formal hearing is not ordered by the Board, the Board may afford the applicant and other properly interested persons (including Governmental agencies) an opportunity to present views orally before the Board or its designated representative." FHDC, its affiliates and community representatives are comprised of "other properly interested persons", yet we were not given an opportunity to present views orally before the Board or its designated representative. Be assured we did ask verbally both Mr. Susan and Ms Nardolilli of your staff if we could attend the Board meeting and were told that we could not. No other meeting was suggested by either of the above parties.

The Federal Reserve Board is condoning blatant discrimination by:

1. Refusing to hold a public hearing in Arizona which would afford the opportunity of its minority and rural populations to speak to the issues of personal experiences with Valley National Bank's discrimination in its lending practices to women, minorities and rural residents.
2. Totally ignoring FHDC's statements of why a written presentation would not suffice in lieu of a hearing.
3. Totally ignoring FHDC's statistical review of VNB's unacceptable housing and community development lending practices to minority and other rural residents.

Basically on the above three points of discrimination, the Federal Reserve Board refused to consider the evidence presented that showed that a significant portion of the 40 per cent of the population of the State of Arizona spreads over a wide geographic area was experiencing discriminatory problems with Valley National Bank loan practices. That many of the people who have lending issues with Valley National Bank are monolingual, women, hispanic and farmworkers as well as low and moderate income people and need a forum to be heard so that their cases can be documented as evidence that the Valley National Bank lending system is not working in the target areas in which they provide services.

Apparently the Federal Reserve Board chose to ignore FHDC's statistical data that was presented in a format that easily identified census tracts in favor of VNB's submission that did not identify census tracts but spoke of communities in general. VNB's data showed 1,412 loans at the VNB's San Luis Branch compared with 869 loans at the VNB Tower of Plaza Branch in downtown Phoenix. The following comments on those statistics:

1. There is no information on the median income of the census tracts or minority populations, particularly for the downtown Phoenix branch. It is doubtful if the borrowers live near the Tower Plaza branch. The Phoenix branch is not located in a high housing density area and probably serves more large business and commercial developers than any other type of customer.
2. All the other listed branches are outside the City of Phoenix either in the urban areas or rural areas and actually substantiate PHDC point of discriminatory lending practices under the CRA to rural and urban communities. The following residential and business loans are taken directly from the statistics submitted by VNB in its October 14, 1987 submission:

|              |          |
|--------------|----------|
| a. Tolleson  | 16 loans |
| b. Gila Bend | 13 loans |
| c. Mesa      | 14 loans |
| d. Glendale  | 18 loans |

3. Of the 1,412 loans at the San Luis Branch only 111 are for residential or business. 1,263 loans have nothing to do with residential, business or commercial holdings and of those 777 are for personal unsecured loans. Since members of the Comité de Bien Estar are having such difficulty in getting mortgage loans and personal secured loans to build their homes, we would like to know who are the people receiving other personal unsecured loans? Are they going to Mexican Nationals across the border? They certainly are not going to the over 300 members of the Comité de Bien Estar.

PLEASE NOTE, IN CHECKING WITH THE TOWN OF SAN LUIS WATER DEPARTMENT, THEY SHOW 680 WATER HOOKUPS. OF THOSE, 50 ARE FOR COMMERCIAL BUSINESSES. THIS MEANS THAT AT PRESENT THERE ARE 630 FAMILIES RESIDING IN SAN LUIS. SINCE THE SURROUNDING AREAS ARE FARM LANDS IT APPEARS THAT VNB IS CLAIMING CREDIT UNDER CRA FOR SERVING MEXICAN NATIONALS RESIDING IN MEXICO. EITHER THAT OR EVERY FAMILY IN SAN LUIS HAS 2.2 LOANS WITH VNB. WHILE PHDC DOES NOT HAVE ANY PHILOSOPHY OR LEGAL PROBLEM WITH VNB SERVING PEOPLE AND COMMUNITIES OUTSIDE OF THE UNITED STATES, IT DOESN'T SEEM LEGAL TO CLAIM THESE SERVICES/LOANS AS PART OF MEETING THEIR CRA COMMITMENT WITH COMMUNITIES AND RESIDENTS OF OUR COUNTRY, PARTICULARLY SINCE THEY FORCE OUR PEOPLE TO BEG AND PUT UP TWICE THE AMOUNT OF COLLATERAL AS THE VALUE OF THE LOAN. HOW DO WE KNOW IF ANY OF THE 1,412 LOANS ARE GOING TO ANY SAN LUIS RESIDENTS? PERHAPS THAT IS WHY VNB IS RELUCTANT TO DEAL WITH CENSUS TRACTS BECAUSE IT WOULD SHOW MOST LOANS PROVIDED TO MEXICO CENSUS TRACTS.

VNB's October 14, 1987 submission includes two pages, 10 and 11 of loan statistics that simply do not add up. First they have excluded certain loans in page 10, but have included the excluded loans in their totals on page 11. This document is very misleading.

At this point, PHDC would like to enter some new statistics which address VNB's non-compliance with the CRA. Attachment C shows comparisons between two Tucson neighborhoods, one on the Northeast side and one on the Southwest side. Note that, even though the Southwest Sector has a greater population and a greater number of homes, the total money made available for home purchase loans is consistently 5 times greater for the Northeast Sector than for the Southwest Sector.

It appears that both the Federal Reserve Board and VNB has overlooked the intent of CRA or changed it. Quoting from the publication *The Community Reinvestment Act, A Citizen's Action Guide*, "THE REGULATORY AGENCIES HAVE SUGGESTED THAT UNDER THE CRA THE TYPES OF CREDIT MAY INCLUDE RESIDENTIAL LOANS FOR ONE TO FOUR DWELLING UNITS; RESIDENTIAL LOANS FOR FIVE DWELLING UNITS AND OVER; HOUSING REHABILITATION LOANS; COMMUNITY DEVELOPMENT LOANS; AND FARM LOANS OF ALL TYPES. While neither the regulations nor the act itself provide a specific definition of credit needs, the legislative history of CRA makes repeated reference to each one of the types of credit listed above. In any case, this credit listing should be tailored to each one of the institution's local communities, and should not merely repeat the various types of credit the institution is 'prepared to extend' to its entire community."

Included in PHDC's submission of August 18, 1987 was VNB's CRA statement for its service area. All were standardized except for a few words. All repeated the various types of credit the institution is prepared to extend to its entire community. None were personalized for any of the communities. In the only meeting held with VNB officials after PHDC filed its complaint with the federal reserve board, VNB officials repeated time after time that they were "Prepared to extend the same credit programs to each community and would not extend any special or additional programs."

Most of the credit programs listed in the individualized VNB CRA statements were not only the same, but had very little to do with housing and community development. While we commend VNB on their program to provide glasses, pay medical bills and car repairs and hope they continue this program as well as their gift and contribution program, these have very little to do with the intent of CRA. RURAL PEOPLE WANT VIABLE, WORKABLE LOW AND MODERATE HOUSING LOANS AND COMMUNITY DEVELOPMENT LOANS SUITED TO THEIR INDIVIDUAL NEEDS.

To quote from page 6 of *Order Approving the Acquisition of a Bank*, "VNB has an existing program to ascertain community credit needs which involves using marketing and other surveys to determine the credit needs of the communities it serves...." There is no proof in any submission by VNB of the above statement. Their excellent publication, *Arizona Statistical Review* does not deal with the credit needs of the communities. In fact we might suggest to VNB that they use their publication to determine the economic differences between rural and urban and between one rural community and another.

Where are copies of the surveys and their results by community? Where are the individualized VNB CRA statements?

So what we have is the Federal Reserve Board defending VNB by using the same language in that Order that VNB used in their submission. Don't forget that this is the same submission that was used by the Board in non-compliance with its own Rules of Procedure.

ATTACHMENT C

Nowhere in any of VNB's submissions do they address the bilingual or monolingual nature of our states population. None of their media presentations are bilingual or in Spanish. None of their advertisements address programs that specifically address the credit needs of low and moderate income people in VNB's service areas. The advertisements are, quite simply, advertisements for VNB's services. They are not geared towards the low and moderate populations and certainly not towards the minority populations of the rural areas.

By Valley National Banks own admission and that of the Federal Reserve Board in the document Order Approving the Acquisition of a Bank, "Valley National is the largest banking organization in Arizona, operating one subsidiary bank with total deposits of \$9.2 billion, representing approximately 38.8 percent of the total deposits in commercial banks in Arizona." With this in mind, VNB should be doing more for the people in its service area and more to develop the communities it serves.

Sincerely,

*John D. Arnold*  
John D. Arnold, Ph.D.  
Executive Director

CC: William Proxmire  
Henry Gonzalez  
Legislative Delegation  
Cale Ancotte, MITC  
Henry Green

JDA/m

DISCRIMINATORY LENDING PATTERNS  
OF VALLEY NATIONAL BANK  
IN TWO TUCSON NEIGHBORHOODS

Two Tucson neighborhoods were chosen for this comparison: one on the Northeast side (comprising Tracts 40.01, 40.04, 40.10, 40.11, 40.12, 40.13, 40.14, 40.15, 40.21 and 40.22) and one on the Southwest side (comprising Tracts 20, 21, 22, 24, 25.01, 37.01, 37.02, 37.03, 38 and 39.) The aggregate figures for the ten Census Tracts in each Sector are compared below:

|                              | NE Sector | SW Sector | Ratio |
|------------------------------|-----------|-----------|-------|
| Population                   | 45,328    | 61,226    | 3:4   |
| Year-round Housing Units     | 16,726    | 19,080    | 4:5   |
| Median Income                | \$21,592  | \$13,532  | 3:2   |
| Mean Income                  | \$22,601  | \$15,080  | 4:3   |
| % Hispanic                   | 8%        | 62%       | 1:8   |
| % Poverty                    | 19.5%     | 49%       | 2:5   |
| Median Minority %            | 13%       | 63%       | 1:5   |
| Agg. Med. Income as % of MSA | 129%      | 78%       | 2:1   |

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VALLEY NATIONAL BANK'S HMDA REPORTS

Total Home Purchase Loans (in Thousands)

|              |             |           |         |
|--------------|-------------|-----------|---------|
| '82 thru '86 | 61/ \$4,695 | 27/ \$132 | 3:1/5:1 |
| '86 only     | 30/ \$2,114 | 9/ \$425  | 3:1/5:1 |

Note that, even though the SW Sector has a greater population and a greater number of homes, the total money made available for home purchase loans is consistently 3 times greater for the NE Sector than for the SW Sector.

## HOUSING DEVELOPMENT CORPORATION

806 East 48th Street • Tucson, Arizona 85713 • (602) 623-0373

February 16, 1988

Senator William Proxmire  
U.S. Senate  
530 Senate Dirksen Blvd.  
Washington, D.C. 20510

RE: Federal Reserve Board Cover-Up Scandal

Dear Senator Proxmire:

It is becoming ever more apparent to rural Arizonans that the Federal Reserve Board holds in contempt the Community Reinvestment Act of 1977.

A further example of the Federal Reserve Board's collusion with the banks is the cover-up of false and misleading information made by Valley National Bank in their CRA statements during their acquisition of the Fresno Bank.

During the appeal process, PHDC challenged the data given by Valley National as to its lending practices in San Luis, Arizona.

In particular, VNB reported to the Federal Reserve Board it had made in the excess of 1440 loans in San Luis, Arizona. After consulting with the town mayor, he indicated that there were only about 680 water hook ups with 50 being commercial. We then consulted with the San Luis Water Company, which confirmed that there were only 720 water hook-ups of which 50 were commercial. Therefore, VNB would have had to make over 2 loans per family in San Luis in order to meet the approximately 1440 loan figure they claim. In our appeal we even provided the names and phone numbers of the utility company for the Federal Reserve Board to verify.

Further inquiries to the Mayor of San Luis revealed that in the past there was no full time mortgage loan officer and that the local VNB had made some mortgage loans to residents in Master Card credit lines at 19% to 21%.

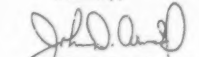
It was very apparent to us that Mr. Wilson did not verify our allegations of false and misleading information. Instead their answer was that the 1440 VNB loans were probably made in part in Mexico and to the local military base. See attached letter page 3, paragraph 2. This answer is totally unacceptable since Congress never intended the Community Reinvestment Act to cover the Republic of Mexico! Also, the nearest military post in Yuma County is the Marine Corps Air Station in Yuma, some 80 miles round trip from San Luis. This base is served by other branches of VNB in Yuma. Therefore, we feel that the Federal Reserve Board is intentionally breaking the law by covering up false and misleading information.

As taxpayers, we have the right to demand an investigation of this cover-up and the loan practices, a criminal penalties imposed on those who falsified federal documents and those who were in complicity. We do not feel that because individuals are federal employees that they should be immune from the penalties for breaking the law.

We would appreciate being put in contact with appropriate federal investigative agencies so that this matter can be pursued and justice served on behalf of rural Arizonans which have been denied equal access to credit and investment capital.

Thank you for your interest in this matter of grave concern to us.

Sincerely,

  
John D. Arnold, Ph.D.  
Executive Director

Enclosure

cc: Bert Haylor

JDA/hr





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

February 1, 1968

John D. Arnold, Ph.D.  
Executive Director  
PPEP Housing Development Corporation  
806 East 46th Street  
Tucson, Arizona 85713

Dear Mr. Arnold:

I am writing in response to your letter requesting the Board to reconsider its action of November 30, 1967, approving the applications by Valley National Corporation, Phoenix, Arizona, to acquire California Valley Bank, Fresno, California. The Board's Rules of Procedure provide that a petition for reconsideration must be received by the Board on or before the fifteenth day after the effective date of the Board's action, and your request, received by the Board on December 14, 1967, is timely.

Section 262.3(k) of the Board's Rules of Procedure provides that the General Counsel of the Board shall determine whether to grant a request for reconsideration. The standard for determining whether a reconsideration request will be granted is whether the request presents "relevant facts that, for good cause shown, were not previously presented to the Board." In addition, this request has been carefully considered in light of your original protest as well as the additional facts you cite as a result of the information that the Board released to you on November 30, 1967.

In its request for reconsideration, PPEP raised three issues: (1) noncompliance with procedural requirements by the Federal Reserve Bank, (2) discrimination by the Federal Reserve System and Valley National Bank against Arizona's minority and rural populations, and (3) inadequate documentation by VNC to prove that it is in compliance with the Community Reinvestment Act.

With regard to your first point concerning noncompliance with procedural requirements by the Federal Reserve Bank, the Board sent the requested information to you as soon as possible once the Board discovered that the Reserve

John D. Arnold, Ph.D.  
Page 2

Bank had not responded to your request for VNC's response. The Board has thus provided you an opportunity to respond to the information as part of this petition and has taken your response into consideration in evaluating your request for reconsideration.

PPEP also argues that the Board was incorrect in considering VNC's response to its protest because VNC's response was sent more than 30 days after the date of the protest. Section 252.3(e) of the Board's procedures states, however, that notwithstanding the general time schedules in the Board's procedures, the Board, in its sole discretion, may take into consideration the substance of comments with respect to an application that are not received within the time periods provided. Thus, even though VNC's response may have been received outside the specified time period, the Board's procedures provide that the Board could take those comments into consideration. Finally, PPEP asserts that its request for a hearing was improperly denied and that PPEP's request to present its views to the Board in person was improperly denied. Board staff informed PPEP that Board meetings on specific applications concerning bank acquisitions are generally closed because the financial condition of the institutions involved are provided to the Board for its consideration. In addition, although there may not have been ample opportunities prior to the meeting to submit PPEP's comments into the record, PPEP's ability to submit additional written comments as part of the petition for reconsideration has provided PPEP with adequate opportunity to address the Board.

With regard to your actual complaint, PPEP continues to assert that VNC's subsidiaries are discriminating against rural areas in Arizona. PPEP disagrees with the Board's analysis of the statistical data, and in particular, PPEP argues that VNC's data do not indicate that VNC's subsidiaries are making loans to low-income borrowers. PPEP also questions whether the loans that are made by the San Luis branch of VNC's lead bank are going to individuals in the rural areas of the United States. PPEP alleges that, based on its analysis of the data, that many of the loans are going to Mexican nationals instead of going to meet the needs of low- and moderate-income individuals in the United States. PPEP also asserts that the CRA statements for the VNC subsidiaries are all very standardized and are not personalized for each of the communities it serves. In addition, PPEP also argues that VNC's charitable contributions do not solve the problems surrounding VNC's lending practices.



John D. Arnold, Ph.D.  
Page 3

FPEP's analysis presents no facts that the Board did not consider at the time the application was approved. Board staff has carefully reviewed your petition and has determined that VNC's subsidiaries provide the majority of the home improvement loans in the low- and moderate-income areas of Tucson and that they provided more mortgages and home improvements per 1,000 owner occupied units to the lower income areas than to the higher income areas in Tucson.

With regard to the specific activities of the San Luis branch, staff analysis indicates that the branch operates in a service area much larger than San Luis itself because of the rural nature of the surrounding area and the existence of several military posts. Accordingly, although the branch may make some loans to Mexico, the economic activity in the area supports a finding that the branch is providing loans to residents of the United States.

Moreover, as the Order notes, the Board based its approval on VNC's commitments to continue to strengthen its marketing and education efforts in all segments of its service area and to expand throughout the state its special lending programs to low- and moderate-income areas, especially rural areas. The Board believes that fulfillment of these commitments will help meet your concerns, and the Board will monitor VNC's commitments in future applications to ensure that VNC is meeting its commitments and fulfilling the requirements under the CRA.

For the reasons indicate above, the General Counsel has determined that no new facts have been presented that would provide a basis for reconsideration of the Board's decision in this case. Accordingly, pursuant to the authority delegated by the Board to the General Counsel in section 245.2(b)(7) of the Board's Rules Regarding Delegation of Authority and after consultation with the Directors of other interested Divisions of the Board or their designees, your request for reconsideration is hereby denied.

Very truly yours,

*William W. Miles*

William W. Miles  
Secretary of the Board



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

November 30, 1987

EXHIBIT 3  
RECEIVED

DEC - 1 1987

CASHIER'S DEPT.  
ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

Mr. G.E. Wright  
Senior Vice President and Secretary  
Valley National Corporation  
241 North Central Avenue  
Phoenix, Arizona 85004

Dear Mr. Wright:

The Board of Governors of the Federal Reserve System has approved the following application filed pursuant to the Bank Holding Company Act.

Valley National Corporation, Phoenix, Arizona ("Applicant"), to acquire California Valley Bank, Fresno, California ("Bank").

In its consideration of these applications, the Board has relied on the following commitments made by Valley National Corporation:

1. Applicant will contribute additional capital to Bank such that at consummation Bank will have a minimum primary capital ratio of at least seven percent; and
2. Applicant will not engage in real estate investment, securities, insurance, or other nonbanking activities through Bank or its subsidiaries without prior Board approval.

Material related to the Board's action is enclosed. Please advise the Federal Reserve Bank of San Francisco in writing when the approved action is consummated.

Very truly yours,

*James McAfee*

James McAfee  
Associate Secretary of the Board

Enclosures: 1. Press Release  
2. Order

cc: Federal Reserve Bank of San Francisco

FEDERAL RESERVE press release



FEDERAL RESERVE SYSTEM

Valley National Corporation  
Phoenix, Arizona

Order Approving the Acquisition of a Bank

For immediate release

November 30, 1987

The Federal Reserve Board today announced its approval of the application by Valley National Corporation, Phoenix, Arizona, to acquire California Valley Bank, Fresno, California.

Attached is the Board's Order relating to this action.

Attachment

Valley National Corporation, Phoenix, Arizona ("Valley National"), a bank holding company within the meaning of the Bank Holding Company Act (12 U.S.C. § 1841 et seq.) ("BHC Act"), has applied for the Board's approval under section 3(a)(3) of the BHC Act (12 U.S.C. § 1842(a)(3)) to acquire California Valley Bank, Fresno, California ("Bank").

Notice of the application, affording an opportunity for interested persons to submit comments, has been given in accordance with section 3(b) of the BHC Act (52 Federal Register 36,003 (1987)). The time for filing comments has expired, and the Board has considered the application and all comments received, including comments in opposition to the application from the PPEP Housing Development Corporation ("PPEP"), Tucson, Arizona, and the Salt Lake Citizens Congress, Salt Lake City, Utah (collectively, the "Protestants"), in light of the factors set forth in section 3(c) of the BHC Act (12 U.S.C. § 1842(c)).

Section 3(d) of the BHC Act, 12 U.S.C. § 1842(d), the Douglas Amendment, prohibits the Board from approving an application by a bank holding company to acquire a bank located outside the holding company's home state, unless such

acquisition is "specifically authorized by the statute laws of the state in which such bank is located, by language to that effect and not merely by implication."<sup>1/</sup> The statute laws of California authorize an out-of-state bank holding company, with the approval of the California Superintendent of Banks, to acquire a California bank or bank holding company provided that the state laws of the acquiring institution has substantial reciprocity with California law and that the transaction will not have an adverse effect on the public's convenience in California.<sup>2/</sup>

The California Superintendent of Banks has found that Arizona has an interstate banking statute that has substantial reciprocity with California.<sup>3/</sup> Based on its own review of the record, the Board has determined, as required by the Douglas Amendment, that the proposed acquisition is specifically authorized by the statute laws of California, subject to Valley National's obtaining the approval of the California Superintendent of Banks pursuant to section 3776 of California Financial Code.

<sup>1/</sup> A bank holding company's home state is the state in which the operations of the bank holding company's subsidiary banks were principally conducted on July 1, 1966, or the date on which the company became a bank holding company, whichever is later. 12 U.S.C. § 1842(d). Valley National's home state is Arizona.

<sup>2/</sup> Cal. Financial Code § 3770 et seq. (West 1968 and Supp. 1967).

<sup>3/</sup> See December 23, 1966, letter to Valley National Corporation from the California Superintendent of Banks.

Valley National is the largest banking organization in Arizona, operating one subsidiary bank with total deposits of \$9.2 billion, representing approximately 38.8 percent of the total deposits in commercial banks in Arizona.<sup>4/</sup> Valley National also operates commercial banks in Utah. Bank is the 170th largest of 432 commercial banking organizations in California, controlling total deposits of \$73.0 million, representing less than 1 percent of total deposits in commercial banks in California. Consummation of the proposal would not have any significant adverse effect upon the concentration of banking resources in Arizona or California.

Valley National and Bank do not compete directly in any banking market. Accordingly, consummation of the proposal would not eliminate any significant existing competition in any relevant banking market. The Board has also considered the effects of the proposed acquisition on probable future competition in the markets in which Valley National or Bank, but not both, compete. In light of the existence of numerous potential entrants into the relevant markets, the Board concludes that consummation of the proposed transaction would not have any significant adverse effect on probable future competition in any relevant banking market.

<sup>4/</sup> All state banking data are as of December 31, 1966.

The financial and managerial resources of Valley National, its subsidiaries, and Bank are considered satisfactory and consistent with approval.

In considering the convenience and needs of the communities to be served, the Board has also taken into account the record of Valley National under the Community Reinvestment Act (12 U.S.C. § 2901 et seq.) ("CRA"). The CRA requires the Board, in its evaluation of a bank holding company application, to assess the record of an applicant in meeting the credit needs of the entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation.

With regard to Valley National's CRA record, the Board has considered the extensive comments from both Salt Lake Citizens Congress and PPEP. Salt Lake Citizens Congress requests that the Board not approve the application until Valley National's Utah subsidiary, Valley Bank & Trust ("VB&T"), provides loans to low- and moderate-income areas and cashes government checks for persons with valid identification. PPEP requests that the Board not approve the application until Valley National's Arizona subsidiary, Valley National Bank ("VNB"), demonstrates that it is meeting the credit needs of low- and moderate-income residents in rural service areas and that Valley National has a satisfactory CRA performance in rural service areas.

In accordance with the Board's practice and procedures for handling protested applications,<sup>3/</sup> the Board reviewed the CRA record of VB&T and VNB, the allegations made by Protestants, and Valley National's response. Valley National has met with Protestants in an attempt to address their concerns. The parties, however, were unable to come to a resolution of their differences.

With regard to VB&T's performance, the Board notes that the bank has a number of programs in place that are monitored by an executive vice president who reports directly to the President of VB&T. VB&T is active in providing home purchase and home improvement loans to most of the low- and moderate-income census tracts served by VB&T. In addition, the record indicates that VB&T participates in several community development activities, including serving as an SBA preferred lender, participating in a home improvement loan program initiated by a local development agency, investing in municipal bonds, supporting Utah's guaranteed student loan program, and collaborating with many neighborhood groups.

The Board has also considered the CRA record of VNB. A full-time CRA compliance officer monitors the CRA activities of VNB and reports directly to an officer of VNB who is a

<sup>3/</sup> See 12 C.F.R. § 265.25(c).

member of the executive committee of VNB and the executive committee of Valley National. VNB has an existing program to ascertain community credit needs which involves using marketing and other surveys to determine the credit needs of the communities it serves, as well as having its officers and directors participate in a variety of community organizations. VNB advertises its services through radio, television, print, and billboard media; is active in providing mortgage and home improvement loans; participates in FHA Title I lending programs; and has a CRA loan program designed to offer extended-term loans to residents of federally designated low-to-moderate-income level census tracts.

With respect to the Protestants' assertions, a review of VNB's loan portfolio indicates that there is a reasonable distribution of loans between urban and rural areas, given the fact that over 75 percent of the state's population resides in Phoenix and Tucson. In order to strengthen its CRA performance in certain low- and moderate-income census tracts within the Phoenix and Tucson MEAs, VNB has agreed to strengthen its marketing and consumer education efforts in all segments of its service area. VNB will expand throughout the state its special lending programs geared to low- and moderate-income persons, especially in rural areas. Based on all the facts of record,

the Board concludes that the convenience and needs of the communities to be served are consistent with approval.<sup>5/</sup>

Based on the foregoing and other facts of record, the Board has determined that the application should be, and hereby is, approved, subject to the express condition that Valley National obtain the approval of the California Superintendent of Banks pursuant to section 3776 of the California Financial Code. This transaction shall not be consummated before the thirtieth calendar day following the effective date of this Order, or later than three months after the effective date of this Order, unless such period is extended for good cause by

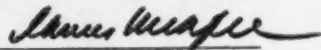
<sup>5/</sup> PPEP has also requested the Board to order a public meeting or hearing to receive public testimony on the issues presented by this application. Although section 3(b) of the BMC Act does not require a public meeting or formal hearing in this instance, the Board may, in any case, order a public meeting or formal hearing. See 12 C.F.R. § 262.3(e). The Board's Rules of Procedure also provide that a public meeting may be held to clarify factual issues related to an application or to provide an opportunity for interested persons to testify. 12 C.F.R. § 262.25(d). However, in its request for a hearing or a meeting, PPEP does not present any material questions of fact that are in dispute. In accordance with the Board's guidelines, Valley National and PPEP have met privately to discuss this application and have exchanged extensive correspondence. In the Board's view, the parties have had ample opportunity to present their arguments in writing and to respond to one another's submissions. In light of these facts and other facts of record, the Board has determined that a public hearing or public meeting is not necessary to clarify the factual record in this case and would serve no useful purpose. Accordingly, PPEP's request for a hearing is hereby denied.



-8-

the Board or by the Federal Reserve Bank of San Francisco, acting pursuant to delegated authority.

By order of the Board of Governors,<sup>2/</sup> effective November 30, 1987.



James McAfee  
Associate Secretary of the Board

<sup>2/</sup> Voting for this action: Chairman Greenspan and Governors Johnson, Seger, Angell, Heller, and Kelley.



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20531

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

November 30, 1987

Barbara C. Toomer, Director  
The Salt Lake Citizens Congress  
347 South 400 East  
Salt Lake City, Utah 84111

Dear Ms. Toomer:

The Board of Governors of the Federal Reserve System has approved the application of Valley National Corporation, Phoenix, Arizona, to acquire California Valley Bank, Fresno, California.

Enclosed are the press release and the order reflecting this action.

Under the Board's Rules of Procedure (12 C.F.R. Part 262), you may request the Board to reconsider this action in accordance with section 262.3(k) of the Board's Rules, a copy of which is enclosed. Please note that the Rules of Procedure provide that any such petition for reconsideration must be received by the Secretary of the Board no later than the fifteenth day after the effective date of the enclosed Order.

Very truly yours,



James McAfee  
Associate Secretary of the Board

Enclosures

cc: Federal Reserve Bank of San Francisco  
Valley National Corporation ✓

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# Bank deal's OK by Fed protested

Community groups requesting hearing

By FRANCIE NOYES  
The Arizona Republic

A federal agency's approval of First Interstate Bancorp's acquisition of a Texas bank has provoked plans for a demonstration in San Francisco by community-development groups from six Western cities.

The community activists say the Federal Reserve Board favors the banks instead of the communities the banks serve. The protesters want an oversight hearing by the U.S. Senate into the Fed's relationship with the banks.

"What may be missed is that the Federal Reserve is contributing, literally, to the death of (inner) cities and rural communities. Unless the banks reinvest, the cities and the rural areas deteriorate and they die," said Bill Scriven, a consultant with the National Training and Information Center of Chicago who is coordinating the protests.

On Sept. 28, the Federal Reserve Board approved the acquisition of Allied Bancshares Inc. of Houston by Los Angeles-based First Interstate, the parent company of First Interstate Bank of Arizona and subsidiaries in other states.

A number of community groups had challenged First Interstate's acquisition under the federal Community Reinvestment Act. The act, passed in 1977, says a bank must make loans in areas in which it does business. Its loan performance is subject to review when it applies for permission to make an acquisition.

The demonstration in San Francisco will be conducted by groups from Salt Lake City; Fresno, Calif.; Tucson; Houston; Seattle; and Missoula, Mont., Scriven said.

"They will be demanding the Fed

— Fed, C2

C2 THE ARIZONA REPUBLIC V

## FED

Continued from C1

reconsider the approval of First Interstate's acquisition, and they also will demand that the Senate hold oversight hearings, looking at the activities of the Federal Reserve," he said.

"There's a larger issue here. Historically, the Fed has had a relationship with the banks, and it has not acted in a fair manner in hearing the concerns of community groups."

Rob Supinski, a spokesman for the regional Federal Reserve in San Francisco, said, "If they are saying that we ignored the community groups, my reply is that we do not. We have made a superhuman effort in this regard."

Representatives of the Federal Reserve attended meetings between First Interstate and community groups protesting the acquisition, Supinski said.

"Beyond that, I'll have to reserve comment until we get further substantiation," he said.

The First Interstate office in Los Angeles was closed Tuesday due to electric-power problems in that city, and no one was available to comment.

The protesters who will demonstrate Friday in San Francisco expect the Community Reinvestment Act to be enforced and they expect federal agencies to hold the banks accountable for that obligation, Scriven said.

"In the past 10 years, only two community groups have been granted a public hearing," he said.

"Clearly, we feel that the community is being denied due process. This sends a signal that the Federal Reserve is backing the banks, not the community groups, in the community reinvestment matters. The banks have a friend."

In a related development, the Federal Reserve has extended its review of a challenge against Valley National Bank. Tucson-based PPEP Housing Development Corp. has filed a protest against Valley Bank, saying it discriminates against rural customers in its lending policies. PPEP stands for Portable Practical Educational Preparation.

John Arnold, executive director of the housing group, said he received a letter from the Federal Reserve on Monday saying it is continuing to review the situation.

Arnold had expected a decision from the Federal Reserve by the end of September on its protest and its request for a public hearing on Valley National's policies.

Arnold also said he has written a letter to Valley National Bank Chairman Howard C. McCrady asking for a meeting to resume negotiations.

Steve Roman, spokesman for Valley National Bank, said the Federal Reserve has asked the bank to submit its community-reinvestment information filed last year and update it with current information.

The bank has received Arnold's letter and will respond to it, Roman said.

In addition, a number of other Arizona banks are discussing meeting with the group about its concerns for the rural areas. Arnold said. Only Arizona Bank and MeraBank have scheduled meetings, he said. First Interstate Bank of Arizona has sent some letters, Arnold said.

Charles Hemann, vice president for community relations, said First Interstate will meet with Arnold's group if they can agree on specific topics to be discussed.

THE ARIZONA REPUBLIC

# The Economy

## Rural group is protesting VNB lending

Continued from 1F

months in loans for a program catering to small, family-owned businesses. As part of its five-year plan, PPEP had asked for \$200,000 a year for the next five years for that program.

The complaint could slow VNB's purchase of California-based Valley Bank, Creedon said. The Community Reinvestment Act states that a bank can't buy another bank if it is not serving its present community.

Members of PPEP and some rural communities met with VNB executives Sept. 1.

A second meeting was tentatively scheduled for this week, but Creedon canceled it because of media attention.

"It started to snowball," Creedon said, "and I said, 'Hey, I'd better back off. Let's go back to square one.'"

In his letter to Arnold, Creedon said, "In view of the fact that your organization has chosen to publicize this matter in the media, we do not agree to any further meetings at this time."

Arnold said the organization was justified in going to the press:

"We must take the concerns of the rural areas to the general public."

PPEP intends to examine other banks' records in the state to make sure they comply with the reinvestment act. However, complaints cannot be filed unless the bank applies to acquire another branch or bank.

"We'd also like to serve notice to other banks that there is someone out there watching their record," Arnold said.

The next move is for the Fed to address the complaint. It can hold a public meeting giving people with complaints against VNB an opportunity to speak, or it can dismiss the complaint.

Creedon said he expected the Fed to act fairly soon.

VNB is the state's largest bank.



# Business

Wednesday, October 14, 1987

Tucson Citizen

By JENNIFER BOICE  
Citizen Business Writer

## Senators to review lending

Pressure from community groups, including one in Tucson, apparently will result in a Senate hearing in December into the Federal Reserve Board's regulation of a 10-year-old law.

The Community Reinvestment Act, passed in 1977, requires financial institutions to provide equal credit throughout their service areas.

Gail Cincotta, executive director of the National Training and Information Center in Chicago, said a group of community leaders met last month with Sen. William Proxmire, D-Wis., to express their concerns for the lack of credit available to rural communities. Proxmire is the head of the Senate Banking Committee.

"They very specifically said a Senate oversight hearing was going to happen," Cincotta said.

A staff member of the Senate

banking committee said a hearing was "likely to happen" in early December.

A spokesman from the Fed said the organization has done its job in regulating banks.

"One of the things we found out is we could oftentimes take meetings and hold them in private. It was more productive to have the system facilitate a meeting between protestants rather than a confrontational experience," said Ken Baebel, senior review examiner with the Fed.

In the 10 years of the law's existence, Baebel said, the Fed has held four public meetings, allowing community groups to air

their credit grievances with the banks.

"Not holding a public meeting is not necessarily indicative we have been neglecting our duties," Baebel said.

"The Fed should analyze CRA Statements to make sure enough money is set aside to lend to low-income borrowers," Cincotta said. "In some instances, the Fed has played a deterrent role in meetings with (community) group."

In Arizona, Tucson-based Portable Practical Educational Preparation Inc. filed a protest that Valley National Bank of Arizona has been neglecting rural communities by not making money available for their credit needs.

"Why doesn't the Fed listen to what they're saying?" said John Arnold, executive director of PPEP. "The Fed is helping banks break the law in denying community groups their due process."



# The Daily Dispatch

"The strength comes from the past and the country will be safe" — A. Lincoln

Established 1903

## Minority assistance group challenges Valley National

By Dave Eff  
Dispatch Managing Editor

Alleged discriminatory loan practices in Douglas, San Luis and Ajo have led to a "David and Goliath"-like challenge of Arizona's largest financial organization by a community development group.

The PPEP Housing Development Corporation has requested a public hearing before the Federal Reserve Board on Valley National Corporation's proposed acquisition of California Valley Bank, making 11 claims of discriminatory and "devitalizing" loan practices by Valley National Banks throughout rural Arizona.

Citing the Community Reinvestment Act, PPEP-HDC cites claims of violations by the bank. CRA defines the responsibilities of banks and savings and loans to communities under the Housing and Community Development Act of 1977.

Specifically, it emphasizes that financial institutions have continuing and affirmative programs to meet the credit needs of the community where deposits are received.

In a letter to the Federal Reserve Board, HDC says that VNC's "participation in local community development projects or programs is almost exclusively limited to metropolitan areas and ignores rural communities; that (services) provided at rural branches bears no relation to the demonstrated credit needs of the community; that minority and low-income residents are not offered mortgages or other loans through the bank's local branches."

They also allege the corporation practices this discrimination throughout the rural portion of the state, concentrating solely on the Phoenix and Tucson metropolitan areas.

A bank spokesman said that although he could not discuss specific cases of denied credit cited by HDC because of the Privacy Act, the bank is willing to address the allegations in a hearing.

"The record will show that Valley National Corporation and its subsidiaries and branches demonstrate an affirmative attitude in all our service communities within federal laws and guidelines and sound business practices."

No hearing date has been set by the Federal Reserve Board.

In a related matter, VNB signed a commitment to the Micro Industrial Credit Rural Organization (MICRO) to make a \$50,000 line of credit available for six months at the prime rate. MICRO had sought a \$1 million commitment for five years from the bank.

Friday

September 4

Volume 86, Number 139  
Douglas, AZ 85607 • 25 Cents  
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Wednesday, September 9, 1987

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THE ARIZONA REPUBLIC

## The Economy

## Valley Bank accused of rural-areas snub

### Canceled meeting with group pushing for housing loans

By FRANCIE NOYES  
The Arizona Republic

Valley National Bank has "slammed the door on the rural communities" in Arizona by refusing to negotiate with a Tucson-based community-development group, an official of the group said Tuesday.

James Farias, resource-development planner with the PPEP Housing Development Corp., said the bank's cancellation of a planned meeting this week shows its disregard for its customers in rural communities. PPEP stands for "portable practical educational preparation."

"They simply slammed the door on the rural communities and said from now on, they would only deal with the Federal Reserve Board," Farias said. "Their attitude is that they don't really give a damn. They're saying, 'No more,' they'll do nothing more."

Timothy Creedon, executive vice president of Valley National, said the follow-up meeting was only tentative.

"We decided we better let the process continue according to the Federal Reserve," Creedon said. "That's the reason we canceled."

The housing-development group

has been discussing with the bank since April the bank's lending activities in rural communities. Under the federal Community Reinvestment Act, lending institutions are required to make credit available to low-income borrowers.

Also under the reinvestment act, the public can comment and appeal to the federal government if it feels the requirements of the act are not being met.

The housing-development corporation filed a complaint July 28, timed to coincide with Valley National's acquisition of the California Valley Bank in Fresno, Calif. That acquisition is now before the Federal Reserve Board.

Representatives from the housing group and Valley National met Sept. 1 to discuss the complaint and the group's five-year plan to make credit available to rural communities. According to the housing officials, their group and the bank had agreed to meet again this week.

Farias said the bank then canceled the second meeting because a few newspapers in southern Arizona have printed stories about the first meeting.

"They accused us of a lack of good faith, because the media picked up the story," Farias said.

Creedon said media coverage was a factor.

"I felt now it has become public, we better let the normal (Federal

— Snub, C7

# SNUB

Continued from C1

Reserve) procedure go on," he said.

But more importantly, Creedon said, Valley needs time to compile its own statistics in response to the complaint.

The housing group has requested a public hearing from the Federal Reserve, Farias said.

Valley National has a responsibility to provide adequate credit in the state's rural communities, "especially in towns in which Valley is the only bank in town," he said.

"They not only have the responsibility, they are mandated to do so under the CRA (Community Reinvestment Act). They are mandated to take affirmative action to learn about the special credit needs of low-income customers, and they are mandated to provide credit to low-income customers, as long as it meets safe and sound business practices."

"We don't penalize the rural communities," Creedon said. "We give their credit every consideration."

The group has given Valley National a five-year plan to make more credit available in rural communities. The plan, which calls for a total commitment of \$31.5 million, is aimed at housing and small-business development in rural areas outside Phoenix and Tucson.

"The 140 rural-metro VNB branches cannot be just a one-way door to drain deposits from rural communities while lack of investment capital deprives them of their fair share in Arizona's prosperity," the proposal says.

Creedon disagreed.

"There is no truth at all that Douglas or San Luis suffer because we make loans in south Phoenix," he said. "We meet the spirit of the CRA. In fact, we far exceed it."

In an Aug. 18 letter, John

Arnold, executive director of the housing corporation, sent the Federal Reserve statistics compiled by his organization comparing similar census tracts in metropolitan areas with tracts in rural areas. The bank routinely favored the metropolitan areas, he wrote.

"Examination of the data reveals a consistent bias by the bank in favor of areas with a low minority presence, higher median income and a low poverty rate, regardless

of other factors," according to the letter.

The letter also includes personal reports from rural individuals who had difficulty obtaining credit.

"There is one case where a man was refused a (mortgage) loan on his home but was given a MasterCard credit line through the banks, at the prevailing MasterCard interest rate, to purchase the materials to complete his home," the letter says.





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE  
TO THE BOARD

November 30, 1987

John D. Arnold, Ph.D.  
Executive Director  
PPEP Housing Development Corporation  
806 East 48th Street  
Tucson, Arizona 85713

Dear Dr. Arnold:

The Board of Governors of the Federal Reserve System has approved the application of Valley National Corporation, Phoenix, Arizona, to acquire California Valley Bank, Fresno, California.

Enclosed are the press release and the order reflecting this action.

Under the Board's Rules of Procedure (12 C.F.R. Part 262), you may request the Board to reconsider this action in accordance with section 262.3(k) of the Board's Rules, a copy of which is enclosed. Please note that the Rules of Procedure provide that any such petition for reconsideration must be received by the Secretary of the Board no later than the fifteenth day after the effective date of the enclosed Order.

Very truly yours,

~~Robert~~ James McAffee  
James McAfee  
Associate Secretary of the Board

Enclosures

cc: Federal Reserve Bank of San Francisco  
Valley National Corporation ✓

# Business

## VNB rural lending practices hit

By Leslie Irwin  
Tribune writer

About 30 protesters lined up in front of Valley National Bank's Phoenix headquarters Monday and accused the bank of discriminating against rural communities.

Valley National Bank accepts deposits from small communities but hands out most loans to the more lucrative high-population areas around Phoenix and Tucson, said John Arnold, spokesman for PPEP Housing Development Corp.

PPEP, which stands for Portable Practical Educational Preparation, is a Tucson based rural advocacy group.

Valley National officials say the anti-rural allegations are groundless.

"We do not discriminate against rural communities. We see no reason for these proceedings and this parading around," said Executive Vice President Tim Creedon.

Valley National distributed 35 percent of its mortgage money to the 24 percent of Arizona's population living in rural areas last year, Creedon said.

But the bank is simply juggling numbers, said James Farias, PPEP resource development planner. "Those

### Bank defends record on loan distribution

statistics are a great lie."

The group analyzed Valley National loan information made public under the Home Mortgage Disclosure Act and compared about 1,700 homes in Tucson to the same number of households in rural Ajo, Farias said.

From 1981-86, Valley National made four times as many loans in the Tucson area even though it was the only bank in Ajo, where the average household income also was slightly higher than in Tucson, he said.

Creedon dismissed the advocacy group's findings as inaccurate because PPEP used only "two-tenths of 1 percent" of the population to draw its conclusions.

Valley National will not be the only bank to feel pressure from PPEP. First Interstate Bank is next on the protest hit list, Farias said.

And about 14 other banks will soon receive letters notifying them they have attracted the group's ire, he said.

PPEP is calling for Valley National to

pump an additional \$31.5 million into communities with populations of 35,000 and less over the next five years, Farias said.

PPEP members stood on the corner of Central Avenue and Van Buren Street to pass out pamphlets. Demonstrators held signs sporting such slogans as "Hell no, we can't grow — VNB has all our dough," and "Copper's gone, peso's down — VNB won't lend in towns."

The group, which staged a similar demonstration Thursday at a Tucson branch of Valley National, is challenging the banking firm's lending practices under the Community Reinvestment Act passed in 1977.

Under this law, lenders must demonstrate that the deposits they collect serve the convenience and needs of the communities in which they do business.

PPEP has filed a protest with the Federal Reserve Board challenging Valley National's acquisition of California Valley Bank in Fresno, Calif.

The group's protest has held up takeover approval, and the Fed is expected to either dismiss the allegations or call for a public hearing by the end of this month, Farias said.

Friday, September 11, 1987

Tucson Citizen

BUSINESS EDITOR, JUDY LEFTON, 573

## Rural residents protesting VNB's lending practices

By JENNIFER BOICE  
Citizen Business Writer

A rural advocacy group in Tucson has announced plans to protest the lending practices of Valley National Bank outside of Arizona's metropolitan areas.

Representatives from rural communities, with the group's backing, plan to wrap a red ribbon around the Valley Bank Center in downtown Phoenix on Sept. 22 as a protest.

The advocacy group, Portable Practical Educational Preparation Inc., has filed a complaint with a federal banking agency against VNB, alleging that it is making loans in urban areas to the detriment of the rural areas.

"Tucson and Phoenix are taking everything and leaving nothing for rural communities," said John D. Arnold, executive director of the group, also known as Project PPEP.

VNB denied it is ignoring rural communities where it has offices.

"There is no substance to that complaint," said executive vice president Timothy Creedon. "I spent 20 to 25 years working in the

rural communities, and we feel there is no merit to (the complaint).

"We are the only bank in Arizona that has a bank in every county."

However, members of PPEP said having a bank branch in a rural community is just a first step toward the development of rural areas. Lending money to the residents of those areas is the second step.

"We are trying to push them into taking responsibility for community development," said James Farina, a resource development planner for PPEP. "Valley has more than two dozen towns where they are the only bank in town."

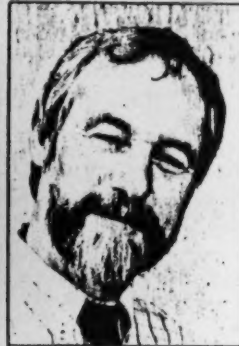
VNB is the only bank in Kearny, Gila Bend, Hayden, Thatcher, San Luis and Superior.

In the complaint to the Board of Governors of the Federal Reserve System, PPEP alleges that the bank violates the 1977 Community Reinvestment Act, which emphasizes the obligation of lending institutions to communities. Under the act, the bank must help meet community credit needs, including those of low- and moderate-income areas.



Timothy Creedon

Tucson Citizen



John D. Arnold

Tucson Citizen

The complaint, filed Aug. 18, states: "Examination of the data reveals a consistent bias by the bank in favor of areas with low minority presence, higher median income and a low poverty rate, regardless of other factors."

The organization compared lending rates among rural and urban areas that had similar median incomes and a similar number of housing units.

Overall in the Tucson and Pima County area, PPEP's study found tracts with less than 40 percent minority occupants outnumber those with a more than 40 percent minority presence by a ratio of 3-to-1. Yet the number of home purchase loans by VNB involving low-minority

tracts in 1985 was 14 times greater than in high-minority tracts.

Many of the high-minority tracts are in rural areas, Arnold said.

Creedon said PPEP's comparisons do not take into account the number of loan applications, which would, naturally, affect the number of loans made.

The bank is going through its accounts to verify or disprove PPEP's claim, Creedon said.

PPEP is asking that VNB make \$31.5 million available for loans in rural areas over the next five years for long-term development.

VNB has agreed to make \$50,000 available during the next six

RURAL, continued/3F



The Arizona Daily Star

Tucson, Wednesday, September 9, 1987

# Money

## VNB practices on home loans favor urban Arizona customers, advocate for rural areas says

By Bob Svejcar  
The Arizona Daily Star

Valley National Bank is turning its back on Arizona's rural communities with discriminatory practices in home mortgage and home improvement lending, a rural aid group charged.

Tucson-based, non-profit, PPEP Housing Development Corp. charged the bank with failing to comply with the federal Community Reinvestment Act of 1977 in a challenge of VNB's plan to acquire the California Valley Bank in Fresno, Calif., submitted to the Federal Reserve Board. The 1977 law requires banks to invest at certain minimum levels in rural areas.

PPEP is trying to pressure VNB into discussions toward gaining \$31.5 million for community development projects and low- and moderate-income housing loans in rural areas.

A finding of non-compliance by the Federal Reserve Board could stall VNB's bank purchase.

The charges are based on a PPEP study of home purchase and home improvement loans provided by VNB between 1981 and 1986 to selected census tracts in rural versus urban areas of Pima and Maricopa counties.

The ratio of urban-area loans to rural-area loans indicates "consistent bias by the bank in favor of areas with a low minority presence, higher median income and a low poverty rate," the PPEP report concludes.

Timothy Creedon, Valley Bank executive vice president and customer service manager, denied any discrimination by the bank in its loan practices in rural areas.

The bank met with PPEP Housing Development Corp. officials "in good faith" earlier this month to discuss the group's request, even after learning of its report to the Federal Reserve, he said.

Creedon and other VNB officials were scheduled to meet again this week with PPEP, but the meeting has been called

off. Creedon said the comparisons between loans to rural and urban areas "have no merit."

The report compares census tracts in the rural areas of Tolleson and Gila Bend in Maricopa County with census tracts in the urban areas of Glendale and Mesa in Maricopa County. The report also compares an urban Pima County census tract with one in rural Ajo, in Pima County. The areas were chosen based on similar income and housing patterns and population.

In comparing the Gila Bend census tract with a comparable census tract in urban Glendale, the report noted that the Glendale area received five times as many home purchase loans and eight times as many home improvement loans between 1981 and 1986.

The Glendale area received more than \$3 million in home purchase and home improvement loans during this period, nine times the amount loaned in

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### VNB

Continued from Page 8C  
the rural census tract, the report said.

"It is of some concern to note that the major differences between the tracts is that the rural tract has a higher poverty rate and a higher Hispanic minority presence than the urban tract," the report said.

Income and minority presence also seemed to play an important role in the number and amount loaned to residents in rural Tolleson, compared with urban Mesa, the report said.

Between 1981 and 1986, the number of home-purchase loans for Mesa was twice that for Tolleson and Mesa received \$1.4 million in loans, compared with less than \$1 million in Tolleson.

Comparing two census tracts in Glendale with one west of Phoenix, bordering Tolleson, the PPEP report found a home-purchase loan ratio of 31 to 1 favoring the urban area in number of loans and a 70 to 1 rate in the dollar amount of the loans.

"The bank has allowed \$99 million for credit losses as of March and has invested one-third of its loan and lease portfolio (\$2.4 billion) in high-risk consumer and credit card loans," John Arnold, PPEP Housing Development Corp. executive director, wrote in an August letter to Howard McCrady, VNB chairman.

"Safe and sound business practice would indicate that investing \$31.5 million over five years in a state-wide rural community development program would offer less risk and greater long-term benefits to the bank and its shareholders," Arnold said.

# Money



Elizabeth Mangelis, The Arizona Daily Star

**Red banner** — Protesters hold a red banner to symbolize their charges that Valley National Bank is "redlining" in denying home and community development loans to rural areas. The protest occurred yesterday outside the bank's downtown office in Tucson. It was sponsored by the PPEP (Portable Practical Educational Preparation) Housing Development Corp.

**The Arizona Daily Star**

Tucson, Friday, September 18, 1987

THE UNITED STATES OF AMERICA

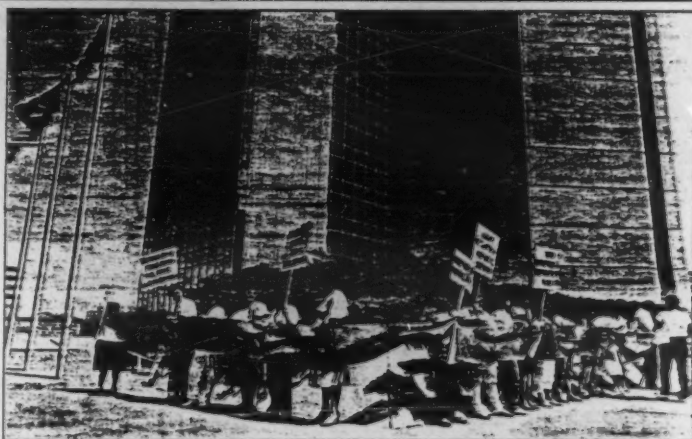
# The Economy



Business  
today

## Dow tumbles 31.62 points

Stocks finish sharply lower in active trading. The Dow Jones industrial average drops 31.62 points, to 2,492.62, after a loss last week of 64.10 points. **BB.**



Charles Hesser/The Arizona Republic

Protesters holding signs and a red ribbon line up outside the corporate headquarters of Valley National Bank in downtown

Phoenix. The group, led by a Tucson-based housing-development corporation, said the bank discriminates against rural

towns by refusing to make adequate loans outside urban areas. The group is made up mostly of residents of the San Luis area.

## Group protests 'redlining' by bank

**Valley National defends policy on rural lending**

By FRANCES HOTES  
The Arizona Republic

Signs reading "Lovers in rural Arizona," and "Hill on, we can't grow. VNB has all our dough," marked a protest Monday by a community-development group outside the corporate headquarters of Valley National Bank in Phoenix.

About 30 demonstrators carried

signs and held a red ribbon to protest what they call Valley National Bank's "redlining" of the state's rural communities.

Valley National Bank discriminates against rural areas by concentrating its business and housing loans in Phoenix and Tucson, said John Arnold, executive director of the Project PPEP Housing Development. PPEP stands for Portable Practical Educational Preparation.

Valley National Bank is the only bank in 20 rural communities, and it is a predominant bank in another 20 communities, but

the rural residents do not get their fair share of loans, Arnold said.

In comparing housing-related loans made in comparable census tracts, the group found a disparity of one loan in urban areas for each loan in the rural area, Arnold said.

Timothy Croaden, executive vice president of Valley National, said the bank makes an appropriate number of loans in the rural areas. The bank has made 35 percent of its mortgage-related loans to rural residents, who represent only 24 percent of the

state's population, Croaden said.

In a letter sent to the Federal Reserve Board on Monday, Croaden wrote, "We feel that this is tangible evidence that we have not discriminated against the rural communities and refuse the allegations included in the material sent to you by PPEP."

Under the federal Community Reinvestment Act of 1977, banks are required to make loans as well as accept deposits in the communities in which they operate. A bank's record on community reinvestment is determined by a com-

— Redlining, B7

## 'REDLINING'

Continued from B5

ber of federal agencies when an out-of-state merger or acquisition is proposed.

The housing group filed a protest with the Federal Reserve Board after Valley National Bank's proposed acquisition of California Valley Bank in Fresno. It also is protesting the acquisition of the Silver King State Bank in Park City, Utah.

Representatives of the rural communities and the bank met Sept. 1 to discuss the complaint and PPEP's economic-development proposal for the rural areas. Valley National Bank has refused to meet with the representatives again.

Many of the protesters Monday are farm workers from the San Luis area, near Yuma, said James Farias, resource-development planner for the housing group.

Farias said the housing group also has sent letters to 13 other Arizona banks, saying it wants to discuss their community-reinvestment records.

Monday's action was the beginning of "an aggressive campaign to notify the banks and savings and loans that do business in rural Arizona to start reinvesting back

into those communities," Farias said.

Marco Antonio Reyes, mayor of San Luis, accompanied the protesters to Phoenix.

"I really don't believe that anybody here really understands what goes on in the rural communities," Reyes said. "They're not going to come to us, so we had to come to them."

The Valley National Bank branch in San Luis has about \$39 million in deposits, but it is difficult for San Luis residents to obtain mortgage loans, Reyes said.

The Valley National branch is the only bank in San Luis, and it does not even have an automated teller machine, Reyes said.

The Silver King bank transaction in Utah is not a pending acquisition, Crendon said. It already was a subsidiary of Valley Utah Corp. when Valley National Bank acquired the parent company. The current change is simply that the name is being changed so Silver King will operate as a branch of Valley Utah.

Crendon expects a decision from the Federal Reserve on the complaint by the end of the month.



The CHAIRMAN. Thank you very much, mayor, for a fine statement.

Our last witness is Shanna Smith, director of the Toledo Fair Housing Center and a very competent activist. You've worked with the Home Loan Bank Board quite a bit I understand. Go ahead.

**STATEMENT OF SHANNA SMITH, DIRECTOR, TOLEDO FAIR  
HOUSING CENTER**

Mrs. SMITH. Yes. My name is Shanna Smith and I'm from the Toledo Fair Housing Center, which is a private nonprofit organization.

You have my testimony. I'm going to highlight sections of that and starting with our experience with the Federal Home Loan Bank Board.

In 1978, the Fair Housing Center, the Greater Toledo Housing Coalition filed the first challenge with the Federal Home Loan Bank Board under CRA. The Bank Board held a hearing. At that time we didn't know that we could ask them to come to Toledo but we traveled to Cincinnati and went through a number of changes to have that hearing.

**INSTITUTION OF AN AFFIRMATIVE MARKETING PROGRAM**

The Bank Board did condition First Federal Savings and Loan's application for a branch. The conditions were that they had to establish a home improvement loan department of which this large major S&L in Ohio had not had. They were to institute an affirmative marketing program and then have semiannual meetings with community groups.

That decision was rendered in 1979. In 1987, First Federal was applying to build another branch bank in the suburban area of Toledo. We challenged that branch application again because they had established a home improvement loan department but in the first half—well, all of 1986, they had made only 36 home improvement loans and 35 of those to white people. For a major lender, as they are, in the Northwest area, that they are not advertising to secure home improvement loans, we were highly critical of their affirmative marketing program for reasons that the Federal regulators who come in and do the examinations are trained for safety and soundness. They are not trained, in our opinion, for fair housing or equal opportunity issues.

When they were told to establish an affirmative marketing program, we tried to advise them what that meant and what they did instead was contract with a white man who became their spokesman. He was not a member of the bank. He just owned an advertising firm and his blond haired, blue-eyed granddaughter would come on the air and say, "You can open up an account at First Federal."

What we tried to explain to them—and I'll ask the people here, how many people here buy Ebony magazine or read Jet magazine? One of the reasons most of the caucasians in this room do not do that is because they don't see their pictures on that magazine. They don't see the advertising directed toward them. They don't pick up the magazine because we don't relate to it.



Likewise, when an advertiser and a lender uses advertising, either on television, radio or in the print media, if only white people are shown in those ads, it has a subliminal message to the minority populations in America that we may not want to do business with you. That is also a violation of title VIII of the Federal Fair Housing Act.

The examiners, however, do not look at those fair housing issues.

In addition, they were told to have semiannual meetings with community groups. Those meetings stopped in 1982 after we went to the meetings and it became a lecture situation from First Federal Savings and Loan.

The situation did not improve and when they applied for the branch bank in 1987 we protested. But before we did that, we started meeting with them—we tried to meet with them in April and June before we filed the challenge and they were unreceptive to any of our suggestions on their affirmative marketing program or that they should have a higher percentage of their loans going into 30 targeted census tracts which includes 83 percent of the black population in Toledo.

#### FHLBB HEARING

As a result, there was no cooperation and we filed the challenge. Now this is when we started working with the Bank Board again. They scheduled a hearing, told us we had to come down to Cincinnati again, and we asked them if the hearing could be held in Toledo because we couldn't afford—I know how you felt about coming here with the expense and time—couldn't afford to go down to Cincinnati to present it. Back and forth we went with the Federal Home Loan Bank Board and we finally got the meeting scheduled in Toledo.

Then, the press wanted to attend the meeting and I was told by a member of the Bank Board that the press would not be allowed into the hearing and I said, "Well, you tell the press that. I'm not going to give that information to the press." And after many discussions back and forth with the news media, they were allowed in. Cameras were not allowed in. And they were not treated courteously by the Bank Board during that hearing.

At that hearing we raised the same issues, that the conditions that were imposed by the Federal Home Loan Bank Board in 1978 and 1979 on First Federal had not been accomplished. They had not been accomplished because the Bank Board did not monitor First Federal Savings and Loan's activities.

The kinds of things we raised in the challenge, in addition to the past problems, included the fact that First Federal had priced itself out of the 90-10 mortgage loan market by having higher interest rates and by having shorter-term years in securing the loan.

Our experience with the Federal Home Loan Bank Board has not been a good one. The kinds of things we want to recommend are that the examiners reports be made available to the public, not those that deal with safety and soundness, but those that deal with the CRA issues.

In addition, we would like to see a private right of action imposed under CRA and I say that because the things that have been

going on in Toledo have been significant. We have had lenders build full service branch banks in the black community. First Federal still does not have a branch there and has said that they will close their doors before they sit down and talk with us as a community group in building a branch bank in the black community, although they have been studying it for 8 years.

Legal action, we have found, in Toledo is the one action that makes the lenders fulfill the commitment under CRA. We have filed protests and as a result of the protests we have a brand new program that's starting that we're pleased with—two points below prime home equity mortgage loans at 10 percent down, but they have to hold that within their own portfolio.

Something that we would also like to see is that the mortgage bankers and financial services be regulated because they're making a tremendous number of the mortgage loans in America and they have no regulation at all. And with title VIII coming up for some revisions, we would like to see Congress and the Senate put in insurance redlining as a violation of the Federal act. We have two split decisions in the courts in the country on whether or not insurance redlining is a violation of title VIII of the Civil Rights Act of 1968. We would like to see that included and specifically to talk about PMI because Fannie Mae and Freddie Mac have said that they have no minimum mortgage loan amounts, yet they have the opportunity to deny 10 percent of a package that goes into Fannie Mae and Freddie Mac and mortgage bankers are telling us that that 10 percent are loans under \$30,000. In Toledo, under \$30,000, that impacts 78 percent of the black community and 72 percent of the hispanic community.

As long as mortgage companies can have minimum low mortgage loan amounts, the ethnic and minority communities in cities across the country are going to be denied fair access to investment.

I have my whole testimony that specifically outlines some other changes.

The CHAIRMAN. We will print that in full in the record.

Mrs. SMITH. Thank you.

[The complete prepared statement of Shanna Smith follows:]

TESTIMONY OF SHANNA SMITH  
EXECUTIVE DIRECTOR, TOLEDO FAIR HOUSING CENTER  
BEFORE THE SENATE COMMITTEE ON BANKING,  
HOUSING AND URBAN AFFAIRS

Community Reinvestment Act Oversight Hearings  
Tuesday, March 22, 1988

I. INTRODUCTION

Members of the Committee, my name is Shanna Smith. I am the Executive Director of the Fair Housing Center located in Toledo, Ohio. The Fair Housing Center is an agency of the Toledo Community Housing Resources Board, Inc., a non-profit corporation organized and existing under the laws of the State of Ohio. The purposes of the Fair Housing Center are to identify and eliminate all forms of discrimination in housing and lending in the Toledo, Ohio area; to educate the public about housing and lending discrimination laws, discriminatory housing and lending practices, and the availability of legal and administrative remedies for discriminatory practices; and to provide counseling and referral services to the public with respect to housing and lending discrimination matters.

Our agency has devoted substantial attention over the past ten years to the problems of discrimination in the financing of housing and the disinvestment by lenders of low and moderate income and minority neighborhoods in the City of Toledo. The first racial redlining discrimination case in the nation, Harrison v. Otto G. Heinzeroth Mortgage Co., 414 F. Supp. 66 (N.D. Ohio 1976), 430 F. Supp. 893 (N.D. Ohio 1977), was filed and successfully litigated in Toledo. Our office has been

instrumental in the investigation and prosecution of at least seven major cases filed in federal district court against lending institutions doing business in the Toledo area. In one of the most recent cases, Old West End Association v. Buckeye Federal Savings & Loan Association, 675 F. Supp. 1100 (N.D. Ohio 1987) the components of a prima facie lending discrimination case were established.

The Community Reinvestment Act has sometimes been an essential tool in our efforts to rid our community of discriminatory lending practices. We have used or threatened to use the CRA protest mechanism as a means of drawing to the attention of lenders and regulators our concerns about certain lender practices. We have found that many lenders will not talk in a meaningful way with us in the absence of some potential risk to their future business plans. Our ability to implement the regulatory CRA protest procedure often poses such a threat to those plans, and it is often only when we threaten to file or actually file a CRA protest that lenders choose to communicate with us in earnest.

Although we firmly believe in the goals of the Community Reinvestment Act and continue to support the CRA protest procedure, the current law and its lack of enforcement by appropriate regulatory agencies cry out for legislative improvement. By answering the questions you have posed to me, I intend during my testimony today to highlight some of the deficiencies we have observed over the past decade.

II. HAS THE COMMUNITY REINVESTMENT ACT HELPED THE COMMUNITIES YOU HAVE WORKED IN?

It is difficult to say whether the CRA has influenced our community in any meaningful fashion. Our agency, as well as the public, does not have the information needed to determine on an objective basis whether the credit needs of low and moderate income neighborhoods are being met better, worse, or the same as they were before the CRA was passed in 1977. Two continuing trends we have observed, however, indicate that the CRA is not a major concern of many regulated institutions.

First, in 1986 we completed a study that measured the overall mortgage lending activity of major Toledo area banks and savings and loan associations over the five-year period 1980-1984 in census tracts with older housing stock, low to moderate income ranges, and minority populations of 25% or greater. In conducting the study we relied upon 1980 census data and Home Mortgage Disclosure Act (HMDA) reports prepared by those lending institutions during the five-year period. We discovered that only one of the 11 institutions studied was providing residential mortgage loan monies to the targeted census tracts at a level that one would expect a lender who was treating all areas of the community on an equal basis. The other ten lending institutions fell far short of the residential mortgage lending activity one would expect if all neighborhoods were being provided with their fair share of the available residential investment capital. One sizable national bank provided only ten residential mortgage

loans in the targeted inner-city census tracts throughout the entire five-year period under study.

While mortgage lending may be just one barometer with which to measure a lender's responsiveness to meeting community credit needs, it is a very important indicator. The failure of most regulated lending institutions over a substantial period of time to meet the residential mortgage credit needs of these low and moderate income neighborhoods in the City of Toledo indicate to us that the Community Reinvestment Act is not being taken seriously by them.

The second trend we have observed in the past few years indicating that the CRA is not being taken seriously enough by area lenders is the increasing frequency with which lenders are closing, or attempting to close, branches within low and moderate income neighborhoods. We have kept a watchful eye over the location and services provided at branches. Two influential lenders have each announced within the past year their intention of closing inner-city branches, citing a lack of profitability. So far we have managed to forestall the actual closing of these branches by filing or threatening to file protests under the CRA. Regardless of whether we may eventually succeed in keeping these branches open, it is disturbing to be consistently told by lending institutions, as we have been, that their commitment to meeting the credit needs of low and moderate income neighborhoods terminates when they decide they can make more money elsewhere.

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This type of attitude, we believe, is inconsistent with the purpose of the Community Reinvestment act. Moreover, in Toledo we have found significant disparities between the services of central city and suburban branches. Similarly, the financial products offered by lenders have become increasingly directed to the affluent. In contrast, the fees for basic banking services have been escalating with the result that low and moderate income customers are "priced out" of the services.

A 1985 study by the American Bank Association noted that "43% of the families earning less than \$19,000.00 per year had to close their accounts for reasons of affordability."

### III. HOW DO YOU MEASURE SUCCESS OR FAILURE?

We measure success or failure by two standards: (1) access to investment capital, and (2) access to services. We believe these two commodities are at a minimum what the term "credit needs" means under the Community Reinvestment Act. The equal availability of banking services is a critical component of the availability of equal access to necessary capital investment, for low and moderate income neighborhood residents and investors feel more secure in borrowing and investing money in their neighborhood only if they believe that the lending community shares their commitment. The development of this mutual trust and commitment to the community is nurtured only when the lender itself becomes part of the community. It does so when it deals with people on a one-to-one basis and makes its services available to them just as it does to the affluent neighborhoods.

As I explained just a few minutes ago, measured only by the investment of residential mortgage loan capital the Community Reinvestment Act has not been a resounding success in the City of Toledo. During the five-year period we studied, of the almost \$800 million in residential mortgage loan money invested in the entire Toledo area, only (38) of those dollars made their way to the targeted low and moderate income census tracts. The results of the study indicated that at the residential mortgage loan level a total commitment under CRA is not being made.

Nor does it appear that lenders are providing equal access to services to low and moderate income residents. Despite the governmental privileges, some lenders will not cash social security or welfare checks.

### IV. WHICH OF THE REGULATORY AGENCIES HAVE YOU WORKED WITH, AND HOW WOULD YOU ASSESS THEIR EFFECTIVENESS IN IMPLEMENTING CRA?

Our office has dealt with the Office of the Comptroller of the Currency, the Federal Home Loan Bank Board, and the Federal Reserve Board.

Our experience with the Comptroller of Currency was not good. The Comptroller's office refused to provide us with a hearing on a challenge to a national bank's decision to remove itself entirely from the residential mortgage market. The Comptroller's office was not bothered in the least by the notion that a nationally chartered bank should completely remove itself



from that capital investment market which more Americans engage in than any other, that is, residential mortgage loans. The Comptroller's attitude appeared to conflict irreconcilably with the intent of the CRA.

Our experience with the Federal Home Loan Bank Board has not been much better. In 1979 First Federal Savings & Loan Association of Toledo applied with the Federal Home Loan Bank Board for permission to open branch offices in predominantly white, suburban neighborhoods. Because of what we perceived to be First Federal's poor record in and commitment to Toledo's low income, minority neighborhoods, we filed a CRA protest with the Bank Board. The Bank Board eventually approved First Federal's request, but imposed three conditions on First Federal: (1) the establishment of a home improvement loan department, (2) the institution of an affirmative marketing program, and (3) the scheduling of semi-annual meetings with interested community groups. Despite it having imposed these conditions, the Bank Board never monitored First Federal's compliance with them. First Federal's commitment to low and moderate income credit needs deteriorated to such an extent that (1) during the first half of 1987 all but one of First Federal's 36 approved home improvement loans went to white applicants, (2) during the first-half of 1987 First Federal advertised in the Toledo minority newspaper only once, and had no television advertisements with minority actors or role models, (3) during 1986 only 3.3% of First Federal's mortgage loan applications were received from

black applicants, and during the first-half of 1987 that percentage had dropped to 3%, (4) First Federal has not conducted the required semi-annual meeting since 1982, (5) the meetings that were conducted were not "community" meetings at all, but rather were structured as lectures during which First Federal officials made offensive comments regarding neighborhoods and minorities.

Because of these and other problems with First Federal that had surfaced since 1979, our agency again in 1987 filed a CRA protest with the Bank Board. Had the Bank Board engaged in any monitoring of First Federal since the 1979 challenge it would have discovered that First Federal was not meeting the credit needs of low and moderate income neighborhoods and that First Federal was not in compliance with the conditions imposed upon it by the Bank Board in 1979. Had the Bank Board engaged in any monitoring of First Federal since the 1979 challenge, a second protest may have been avoided.

Our recent experience with the Federal Reserve Board has been acceptable. The Cleveland office has been responsive to our inquiries and requests, and appears to understand the meaning and importance of the Community Reinvestment Act.

V. WHAT IMPROVEMENTS, IF ANY, ARE NEEDED IN THE CRA EXAMINATION, EVALUATION AND ENFORCEMENT PROCESSES?

Generally speaking, federal regulators need to devote just as much attention to an institution's performance under CRA as

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they do to an institution's safety and soundness. Examiners need to be better trained in the identification of lending discrimination by lenders, including discriminatory underwriting guidelines, prescreening, and discriminatory lending patterns. Examiners need to be more dedicated and committed to community reinvestment.

On a more concrete level, we believe the following mechanical suggestions will greatly improve implementation of the Community Reinvestment Act:

1. Examiner's studies, evaluations, and reports should be made available to the public. The CRA presently covers only publicly chartered institutions. There is no legitimate business or regulatory interest that is served by keeping secret an institution's performance under the various criteria used by examiners. This is particularly true with respect to any part of an examiner's study, evaluation, or report that deals with an institution's performance in meeting the credit needs of low and moderate income individuals.
2. As an indicator of CRA compliance, examiners should determine if the number of mortgage loans is proportional (within one standard deviation) to the number of owner-occupied housing units in low and moderate income areas.
3. Some additional enforcement mechanism should be made available to community groups. Currently the only effective means of challenging a lender's performance under CRA is to file a protest with the pertinent regulator when a lending institution seeks permission to take some action that requires regulatory approval. There is currently no available means of appealing whatever decision the regulating agency makes, nor is there a means of challenging an institution's performance under CRA in the absence of the institution seeking permission to take some act. We suggest that a private right of action be added to the Act, with an explicit provision providing legal standing to community or fair housing groups such as ours. In the alternative, we suggest that an appeal *de novo* be permitted of a regulating agency's decision to approve

or disapprove a lender's request in response to an administrative CRA protest.

4. The Comptroller of the Currency, the Federal Reserve Board, and the Federal Deposit Insurance Corporation should collect and analyze the same data that the Federal Home Loan Bank Board currently collects and analyzes. In particular, all regulatory agencies must collect and analyze applications data, as well as the other data they currently collect and analyze. This applications data should also be made available to the public under the Home Mortgage Disclosure Act.
5. Lenders should be required to place automatically all lawsuits, administrative complaints, and letters alleging unfairness, unequal treatment, violations of any federal or state laws, etc. in their CRA files. Current regulations limit the contents of those files to comments relating specifically to an institution's performance in helping to meet the credit needs of its community or communities.
6. Any residential mortgage loan underwriting policy, pricing policy, or product that has a discriminatory effect on low income applicants should be prohibited. Examples of such policies and products that are increasing among the lending community include: (a) minimum loan amounts, whereby a lender refuses to provide a mortgage loan less than a certain amount; (b) the tiering of interest rates based upon the size of the mortgage loan, whereby applicants for small mortgage loans must pay a higher interest rate than applicants for larger loans; (c) any other policy or practice that applies differing terms and conditions to the procurement of a residential mortgage loan based upon the amount of the loan; (d) customer only policies; (e) the requirement of minimum account balances; and (f) the lack of low equity programs.

#### VI. WHAT FACTORS DO YOU BELIEVE NOW STAND IN THE WAY OF ACHIEVING FURTHER PROGRESS UNDER CRA?

The major factors standing in the way of achieving further progress under the Community Reinvestment Act are the lack of aggressive monitoring and enforcement efforts by regulatory agencies, and the lack of any meaningful enforcement mechanism available to concerned individuals and community interest groups.

These impediments would be significantly diminished if Congress were to adopt the recommendations I have just made. The federal government, through the regulatory agencies, must be just as committed to the purposes of the Community Reinvestment Act as are community interest groups like us. Conversely, those community interest and fair housing groups that have evidenced a commitment to the CRA must be provided a more meaningful role in its enforcement. By implementing the improvements we have suggested, the Act will be substantially strengthened and the low and moderate income neighborhoods in this country will benefit.

I thank the Committee for providing me with this opportunity to express our concerns about the Community Reinvestment Act.

**NTIC** National Training and Information Center  
954 West Washington Boulevard □ Chicago, Illinois 60607 □ (312) 343-3035

**INNER-CITY NEIGHBORHOODS AND THE MI INDUSTRY:  
A REPORT ON CAUSES OF INDUSTRY LOSSES**

March 1988

**BACKGROUND ON MORTGAGE INSURANCE INDUSTRY**

America's mortgage insurance industry is in a better position than ever before to help meet Americans' housing needs. The 12 active insurance providers posted combined 1986 after-tax profits of \$133 million, compared to \$31 million in profits in 1982. Between 1982 and 1986, these companies' insurance coverage rose by 271 percent, their premiums earned rose by 363 percent, and their profits rose by 416 percent. How did profits increase almost twice as fast as policies? By jacking up premiums, making a bundle off investments and capital gains, and not paying a penny in income taxes.

At the same time, the mortgage insurance industry has been paying claims on bad loans at an ever-increasing rate. Almost \$1.3 billion in losses were incurred on bad loans in 1986 alone. As a result, the number of new policies being written are going down, from 380,440 in 1985 to 312,655 in 1986. The heaviest burden is falling on low/moderate income families who require mortgage guaranty insurance on low-downpayment mortgage loans. Without PMI, homeownership becomes an unaffordable dream for millions of Americans.

Who's to blame for the mounting losses in the mortgage insurance industry. One company, THIC Mortgage Company,

accounts for one-fourth of all industry losses. The \$311 million in claims losses incurred by TMIC in 1986 are directly attributable to one cause: massive default on speculative EPIC loans. Similarly, a \$33 million net loss by Republic Mortgage Insurance Company in 1985, their only unprofitable showing in the past five years, is directly attributable to the write-off of tens of millions of dollars in EPIC loans that year.

The fiasco with EPIC symbolizes the deeper cause of mortgage company losses: real estate investments that went awry and general economic turmoil in the South and West. In 1986, loss rates for loans in the South, including Texas, was twice the national average and six times the loss rate for loans in the North East.

The conventional wisdom is that mortgage insurers should cut off the spigot to the South and instead increase their exposure on loans in the North East, where real estate prices are appreciating at twice the national average. Rapid appreciation, low unemployment, and a stable economy will minimize the risk of loss on low-downpayment homes. Meanwhile, all PMI companies have tightened standards and raised premiums on five-percent-down mortgages, which are claimed to be the greatest cause of the industries' problems.

The conventional wisdom is in fact a recipe for disaster --- in fact, it is the very recipe the PMI

companies used to get in the disaster they're now in. In 1980, for example, the South had the highest rate of home appreciation (14.7 percent) and the lowest rate of unemployment (6.07 percent) of any region in the nation. Mortgage insurers were happy to maximize exposure in this presumably "safe" region, as the EPIC loans demonstrate. TMIC insured heavily in the South and West. From 1982 to 1984, they had the second-highest annual profit of all PMI companies. In 1985, the bottom dropped out. During this period, Texas, where TMIC wrote 15 percent of their policies, shifted from the state with the tenth-lowest loss rate (0.25 percent) to the state with the fourth-highest loss rate (2.23 percent).

No one owns a crystal ball, but who is to say that the Hartford of 1991 will be different than the Houston of 1986? By insuring heavily in homes with rapidly appreciating real estate values, the PMI companies are again setting themselves up for huge claim losses if the North East goes into recession and inflated home values plummet, just as they did in the Sun Belt.

The surest guarantee against regional economic dislocations is increasing policies all over the country, so that future losses in any region can be compensated for by huge premium earnings everywhere else. Instead, the companies have tightened policies and increased



premiums, driving millions of potential homeowners to FHA, or out of the market completely. Between 1983 and 1986, the PMI companies' share of all home loan originations dropped from 20.4 percent to 11.78 percent, while FHA's share rose from 11.2 percent to 13.2 percent. Instead of offering affordable premium and underwriting guidelines that met the needs of moderate-income families, the PMI companies sent them and their premiums packing. With less new policies to insulate them, the companies will be even more vulnerable to regional economic problems in the future.

The fundamental question for the PMI companies today is how to eliminate excessive risks in the future. Their natural response has been to tighten up standards for one of the most predictable risks: insurance on 95 percent loan-to-value mortgages, the bedrock of moderate-income home ownership any most inner-city revitalization programs.

But are 95 percent mortgages the cause of the industry's problem? Hardly. To be sure, these mortgages have been and will continue to be about twice as risky as 90 percent mortgages. From 1957 to 1977, for example, the greatest risk of default on low-downpayment mortgages occurred in the third year of payment. During the third year of a mortgage, about 0.75 % of 95 percent mortgages and 0.25 % of 90 percent mortgages resulted

in a mortgage insurance claim. From 1978 to 1986, a number of factors contributed to an increase in both ratios, and a lengthening of the number of years a mortgage remained at higher risk. During these years, the highest losses occurred in the fourth year of a mortgage, when 2 percent of 95 percent mortgages and 1 percent of 90 percent mortgages resulted in a mortgage insurance claim. In other words, the claim rate for 90 percent mortgages in the 1980's exceeded the claim rate for 95 percent mortgages in previous years.

What contributed to the general increase in insurance claims? Recent results have all pointed to the same factors: deregulation of the financial industry that led to a proliferation of unsafe mortgage instruments and sloppy lender underwriting and servicing, regional economic problems that pushed up default rates on mortgages of all loan-to-value ratios, and overbuilt/overpriced new construction and investor-owned housing that was cheaper to default on than resell when home values started to plummet in areas from Florida to Wyoming.

While the actual amount of loss from these categories is undeterminable (except from the hundreds of millions in losses stemming from EPIC), the degree of risk involved in different types of loans can be approximated based on Moody's recent Structured Report on the PMI industry.

As was stated earlier, the highest level of default has occurred during the fourth or fifth year of a mortgage in the 1980's. In 1986, then, the highest likelihood of default would occur on loans originated and insured in 1982. Based on the experience of all mortgage companies, about 1 percent of 90 percent mortgages made in 1982 would result in an insurance claim in 1986. About 2 percent of 95 percent mortgages made in 1982 would result in a 1986 claim. However, the percentage for other types of mortgages were much higher:

- o 5 percent of negative amortization mortgages made in 1982 resulted in a 1986 loss
- o 6 percent of graduated payment mortgages made in 1982 resulted in a 1986 loss
- o 8 percent of mortgages made in Texas in 1982 resulted in a 1986 loss
- o 9 percent of temporary buydown mortgages made in 1982 resulted in a 1986 loss
- o 100 percent of EPIC mortgages made in 1982 resulted in a 1986 loss
- o only 1 percent of fixed-rate mortgages made in 1982 at any loan-to-value ratio resulted in an insurance claim in 1986

While the problems in Texas cut across all types of mortgages and were probably unavoidable, the disproportionately high claim rates in all other categories can be avoided. In 1985, about 10 percent of the industries' insured mortgages were negative amortization, graduated payment, or other instruments that were clearly much riskier than 95 percent mortgages per se. Another 8.6 percent were mortgages on investor-owned properties, again

much riskier than 95 percent mortgages to owner-occupants. The rational approach to managing risks would be to stop insuring investor-owned mortgages and unsafe mortgage instruments. These two single steps would probably have saved TMIC from insolvency.

If the specific risks associated with investor-owned mortgages, unsafe mortgage instruments, and speculative housing with values that depreciate as quickly as they appreciate were factored out, it is clear that the general claims rate on 95 percent mortgages would be much lower than the figures presented by the industry to rationalize their tightened standards. In fact, it would probably approach the claims rate of 0.75 claims per 100 in the worst year that occurred from 1957 to 1977. If the industry survived and prospered in the current environment, they can clearly do well if claims rate return to their pre-1980's levels.

The period from 1957 to 1977 for the most part lacked the kind of wild speculation, overbuilding, rapid appreciation, and profusion of mortgage instruments that can turn quick premiums today into huge losses tomorrow. It was a period characterized by stable home prices, fixed-rate mortgages, first-time homeownership, and good quality control by lenders. Ironically, the FHI companies have turned their backs on community lending

The Chairman. Thank you very, very much.

I think all of you have made some telling and very useful critical comments. Let me ask you if your organization would consider presenting an annual award to lenders who have an outstanding CRA record, a kind of "Golden Enterprise" award?

#### POSITIVE RESULTS OF ACT

Ms. UEBELHOER. It sounds like a good idea. Actually, in our written testimony, we devote a lot of attention to success stories that ACORN has had with the act. For example, we have agreements with two banks in Philadelphia, Fidelity and Continental. They have more than met their lending commitments, and have provided counseling, prepackaging, and marketing services. We're seeing lots of low income people moving into newly rehabbed homes and this is directly a result of the Community Reinvestment Act and the cooperation—wholehearted and earnest cooperation of bankers.

The CHAIRMAN. Philadelphia has done a very good job I understand in general. They were the first ones to get into it and they say they were surprised to find out that when they went into these communities that they had avoided before on ethnic grounds or racial grounds—they found the results were better—not worse but better, if they stuck strictly to having a sound structure and sound credit rating for the first new loan.

Ms. UEBELHOER. Yes. On the other side of that, when Mellon Bank bought out Girard Bank in Philadelphia, Girard had an acceptable record in low and moderate income neighborhoods and Mellon had one of the worst records in the State. We ended up with 15 census tracts in North Philadelphia without a single branch bank, and a significant drop in mortgage lending activity in low and moderate income neighborhoods.

The CHAIRMAN. Ms. Cincotta?

Ms. CINCOTTA. What we try and do all along in everything is make sure that the banks get credit for doing good, that they get awards, that they get good publicity. We think that the CRA investment is a win-win situations for the people and the banks. And if regulators come in and ask us about the banks, we make sure and say which banks are doing a good job and which ones aren't and why.

So I just think that is important, that the institutions do get applauded and do get good press when they do good work. I think, again, the CRA has worked because the people have made it work, not because of the regulators. That's the problem.

The CHAIRMAN. You've all been very critical of the regulatory agencies on charges of grading inflation in which they say everybody is doing great even if they're doing very badly.

Let's turn the tables and let you grade the regulators, using a traditional A, B, C, D, E, F—F for fail and A for terrific. And let's go right down the line. The Home Loan Bank Board?

Ms. CINCOTTA. Well, the Home Loan Bank Board, when they had the CIF fund that was operating before the deregulation, were doing creative programs. When deregulation came in and there were a lot of losses of the savings and loans and the CIF fund was depleted, they went to a stage of not doing much of anything

except trying to save the industry and my hope is that they are going to get back into how they were before.

The CHAIRMAN. Any other comment on the Home Loan Bank Board?

Mrs. SMITH. I think they've done a very poor job in our area.

The CHAIRMAN. Would you give them a D or an F?

Mrs. SMITH. I would give them an F, because we had our hearing in November. Our Congresswoman, Marcy Kaptur, wrote a letter and asked when the report would be and they said mid-February, and we still do not have a decision on First Federal Savings and Loan and it's the end of March.

The CHAIRMAN. How about the Federal Reserve Board, Mayor.

Ms. CINCOTTA. The Federal Reserve Board is to me a mixed bag. In Chicago, because they know us, they've been very cooperative and helped move things along. And from what we're hearing from the Southwest, the groups we work with and everywhere else—again, they're not bad in some areas where you've established relationships.

The CHAIRMAN. It depends on the local personnel, I take it?

Ms. CINCOTTA. It depends on local personnel. In the West, like California, they're just fronting for the financial institutions.

Mr. REYES. I agree. I would give them an F in our area. Our experience with them has been all around bad.

The CHAIRMAN. Is there anybody who wants to grade the Comptroller?

Ms. CINCOTTA. The Comptroller is interesting. They hold dozens of training sessions and meetings. That doesn't necessarily translate into denials or bad ratings. They do a wonderful PR job, but it doesn't translate into actually where the lenders put the money in or agreements come in or applications are denied, but they do the best PR job for themselves.

The CHAIRMAN. My time is up. Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

This has been an extremely helpful panel and I want to thank each of you for the specificity with which you have analyzed the circumstance in your particular community with which you are most knowledgeable.

You've indicated that banks are at a range, some meriting the Golden Enterprise awards and others getting F's on your report card.

What are some of the characteristics that would distinguish those who get A's from those who get F's?

#### CHARACTERISTICS THAT DETERMINE SUCCESS

Mr. REYES. I would say that it's the understanding of what the CRA really means in terms of what they are supposed to do. I think that it's a wide range of understanding. You go out there and if you just say that all that's required is for them to make safe, sound loans on a practical basis, they just simply will refuse because of the area or et cetera. We look at it as a tool for us to have access to certain loans that might be marginal in terms of their safety. But we're saying, in our case, we're so close to the border, we're saying, "Look, you do this for people across the border on an

international basis. You lend billions of dollars across the border and you can't lend our community that is on this side of the border enough to even build on." And they're saying, "We make loans. We just can't make bad loans." We're saying, "Well, how can you do that? How can you not even give us the benefit of a doubt?" People are living on this side of the border and you have access to them, but you lend to people across the border. Why can't you even give us a chance? I don't think they understand that concept.

Senator GRAHAM. Mrs. Smith.

Mrs. SMITH. We've been working with them to design programs that meet the credit needs of the low and moderate income community, specifically not requiring 20 percent down, and we've developed programs where they will require 10 percent down. Part of that may come from our Community Development Department in the form of a grant. And then increasing their income-to-debt ratio, so that low income families who may already be paying 40 to 50 percent of their income for rental housing would be paying that same proportion for the purchase of homes.

In addition, the low equity program has reduced the interest rate. We have two lenders who are instituting programs now that are two points below prime and that reduction reduces the monthly payment which brings them into income-to-debt ratio that's necessary.

There's also been—we're establishing a \$200,000 revolving loan fund that will be operated through a lender with donations from other lenders to help write down the cost of the interest rate so that other families can be involved.

Plus a mortgage rehab program. Many lenders will give you the loan but won't give you the rehab money at the same time. And Ohio Citizens, who we challenged in 1979 because they made zero loans in neighborhoods, has instituted this program. They are now making 14 percent of their mortgage loans in the 30 targeted census tracts that include hispanic and black populations in Toledo. They have come a long way in the last 10 years. They are developing programs that will meet the credit needs. Also basic banking programs that, instead of \$300 to open an account, it may be \$10 to open an account with a low monthly service fee or no monthly service fee as they have for many senior citizens.

Ms. UEBELHOER. In addition to what the other panelists have said, much which I agree with, I'd like to stress that bankers who are willing to go out into low income communities and get to know the people and the kind of problems that they face, often overcome their stereotypes about low income people and racial minorities, and become motivated to work cooperatively and creatively to meet credit needs in those communities.

The cultures in which bankers and regulators move differ so radically from the cultures in which low income people live their lives that this gap needs to be bridged before cooperative programs will be established and will succeed.

Mr. REYES. It's been a tough fight to convince them this is a win-win situation. Obviously, we think that it works out and it's worked out in other communities. It's just tough. Banks in the Southwest, especially the one we have to deal with, Valley National Bank, which is a large bank and is a very conservative bank,



just don't want to get into this thing. They'll say, "We just don't want to, period. We just don't want to get into these types of programs that are marginal. We like to go after the safe—I guess safe—loan type situation." And we're saying we thought that this act was going to help us solve that problem where they had to have a little flexibility and allow for a little more margin for a little less safety.

Ms. CINCOTTA. One of the things we've found, we have met with banks in Chicago and with groups across the country before CRA comes into play, and we've tried it with this is what's needed and this is what you're not doing during the examination period when the regulators are in, and what we've found is it takes the CRA application before you can work out a deal. Even trying it ahead of time doesn't work.

So that if lenders would look more carefully, I think a lot of them just do not know their neighborhoods, their cities, and that they're afraid, and what we have found is that the best tool is putting them in a bus or van or car and driving them around, getting to meet the nonprofits, letting them see the buildings, and trying to have them understand we are not about the business of trying to have them make bad loans with bad credit risks on bad buildings. It's not to our advantage. We want them to make money in our neighborhoods so they see it as a good book of business and institutionalize it. That's the hardest story to get across.

Senator GRAHAM. Thank you, Mr. Chairman.

The CHAIRMAN. Well, thank you, folks, very, very much. For the record, I wish you would file with us your rating on all of the regulators—the Home Loan Bank Board, the Fed, the Comptroller of the Currency, FDIC—so that we have a basis for judgment. Thank you. You did an excellent job and we're very grateful to you.

Our next witnesses are a panel of three research experts, Calvin Bradford, Hubert Humphrey Institute of the University of Minnesota; Elspeth Revere, Woodstock Institute; and Allen Fishbein, Center for Community Change.

Mr. Bradford, go right ahead, sir.

#### STATEMENT OF CALVIN BRADFORD, SENIOR FELLOW, HUBERT HUMPHREY INSTITUTE OF PUBLIC AFFAIRS

Mr. BRADFORD. Thank you very much, Mr. Chairman.

My name is Calvin Bradford. I'm a senior fellow at the Hubert Humphrey Institute of Public Affairs at the University of Minnesota. I've been studying economic development and disinvestment and reinvestment for the past 15 years. I'm submitting a detailed written statement with some support documents and I just want to highlight the themes of that statement right now and give a couple of examples.

First, one of the major questions is, is there an unmet credit need out there that banks aren't serving? The Community Reinvestment Act was born out of the antiredlining movement and I would just like to say, in support of what other witnesses have said, from the point of view of formal, sophisticated research that's been done over the years continually and most recently in cities like Denver, Baltimore, Philadelphia, Chicago, Washington, DC., and

now in Atlanta, the persistence of race as a determining factor in lending is consistent. It still shows up as a major factor. Redlining hasn't gone away.

There is a second issue, though, directly related to the deregulation process and to increased competition in the banking community. That is what the economists—particularly economists writing for the Fed in their various journals—talk about when they say deregulation has made the capital markets more efficient.

#### DEREGULATION

What they mean by that definition is that money flows from what they call capital surplus areas to capital short areas. But this is a kind of economic double-think, when you find out what they mean by a capital surplus area. They're talking about rural farmlands as in Wisconsin and Minnesota and inner city neighborhoods. They're talking about cities in the Northeast and in the Midwest. The growth areas they're talking about are upscale markets, large corporate markets, and foreign investments. So that their very definition of a successful Federal policy of deregulation is essentially to applaud for an increased disinvestment. I think this is a serious issue.

There is no development banking industry in this country and yet in every other country in the world any one of those communities I described would be called a credit shortfall area. Whenever there's a lagging economic market in another country, we consider it a primary need to get investors and lenders to put their money into it. In our country, we encourage lenders to invest in foreign countries, but the only law we have to help them invest in our own lagging economy is the Community Reinvestment Act, which as you've seen I think by the testimony you have, the Federal agencies have not done much to enforce.

The Community Reinvestment Act process itself has become more complicated from the community side for two reasons. One, the community organizations have developed a development banking industry. As we said, we were talking about this \$5 billion of reinvestment that we've seen, and they've moved from simply trying to gain access for single family homes to the process of housing development, business development, and rebuilding the very nature of the financial infrastructure and capacity in communities to develop the entire economy of those communities. This is a complicated process.

Second, a local community group is no longer simply looking at its local lender who's always been there and at lenders they might know. Because of interstate banking, they are increasingly looking at a bank coming in from several States away or across the country and they need to know what its local record of service was in some other State and other community and they are no longer dealing with their local regulators but a regulatory agency in another State, as you saw on the video tape.

When Chemical Bank decides to buy Texas Commerce, the decision is going to be made from a recommendation by the Fed in New York and yet the community groups are in Texas. The local ACORN chapter in Phoenix in the last 2 years had to deal with

banks coming in from New York State, from Wisconsin, from Minnesota, and from California. This makes the process very difficult for the groups.

Yet the regulatory agencies have reduced the number of extensions that they have given to groups to try and do their investigations and define their needs and work with these organizations.

#### FEDERAL AGENCIES HAVE REDUCED REGULATORY EFFORT

I'd like to give just a couple of examples that will support the fact that the Federal agencies have reduced their regulatory effort and made a lot of what I would say are arbitrary rules. For example the Philadelphia Fed basically telling people that no matter what the HMDA patterns show, that's not sufficient to turn down a bank, no matter what. The Atlanta Fed, I would say, is basically making a rule that there is no such thing as race discrimination. They had one bank there, Trust Company, that essentially admitted that its loan product, its mortgage product, was only appealing to upper income mobile whites, and yet they said to the Fed, don't apply the effects test to us. The Fed said OK, we won't do that. They did have one loan product which was available and which they thought might appeal to lower income people and minority people and they refused to advertise that. The reason was that they may actually get a lot of applications. The Fed approved their application without comment.

In the State of Minnesota where I come from, Twin City Federal, the largest savings and loan in the State, took a mortgage bond program designed to provide 400 units of low and moderate income family housing and made insider loans to their own development company which was doing condominium conversions, which actually evicted the people the program was designed to serve. We had letters at the CRA hearing from the mayor of Minneapolis who's an exmember of Congress attesting to the seriousness of the issue. The Federal Home Loan Bank Board approved the application without comment.

There are other kinds of issues. One of our groups in Minnesota that wanted to know, is the CRA map, like the green one here which goes along the north shore of Lake Superior, and avoids the Indian reservations at both ends and the miners to the west of this long thin green strip—is it a serious issue if they draw a CRA map like that, or if a bank merger in Mankato in the valley of the jolly green giant right in the middle of agricultural area decides when it consolidates three banks to eliminate all agricultural lending, SBA lending, Farmers Home lending and mobile homes—is that a serious violation of the CRA? They couldn't get a response from the Comptroller. In fact, they had to track down the Comptroller personally in Chicago where he was speaking to try and get his attention. They had to talk to the staff of this committee and the House committee and get a letter from the legal counsel of the House committee and they still haven't gotten a response from the Comptroller about whether that's even a serious issue.

That's the kind of state of affairs people are involved in.

Finally, I would say that one of the frustrations for community people is that when they do eventually become the enforcers them-

selves and file a challenge, they are criticized in the media for blackmail.

My own experience, as I've worked with groups around the country, is I've seen the bankers blackmail the community groups. Marine Bank from Milwaukee, for example, threatened the Women's Economic Development Corp. in Minneapolis that filed a challenge against their application. Marine told them they would never get any grant money in Milwaukee if they didn't withdraw their application. The First Bank System in Minneapolis threatened the group likewise, telling them they would take away their grant money, so the group withdrew their objection.

Citizens and Southern has strong-armed the NAACP to soften up a challenge from Orlando.

So I would say that one of the problems with the regulators in not doing their job is that the burden falls on the community people and it's the banks that I've seen doing the blackmailing.

[The complete prepared statement of Calvin Bradford follows:]

programs that offer the same today. These programs are targetted to inner-city neighborhoods with either stable or slowly-appreciating home values. Their moderate-income residents have to work hard to save the five percent down-payment that will unlock homeownership. They are not speculating. The lenders involved are committed to developing a sound portfolio, and they typically offer reasonably-priced fixed-rate mortgages to do so. Yet in city after city across the country, the FMI companies are turning these loans down. Their guidelines on neighborhood analysis, loan-to-value ratios, and borrower characteristics redline sound buyers.

Without national regulation of the FMI industry, the companies will continue to make insurance most available to those who need it the least. Worse, they will gauge customers with premium increase to pay for their gambles on speculative or rapidly appreciating homes. The companies could stand to learn something from the moderate-income borrowers they redline: in order to get something for the long run, you have to earn it the hard way.



Statement of Calvin Bradford  
Senior Fellow  
Hubert Humphrey Institute of Public Affairs  
March 22, 1988

My name is Calvin Bradford. I am a Senior Fellow at the Hubert Humphrey Institute of Public Affairs of the University of Minnesota. For the past fifteen years, I have engaged in research, teaching and writing on the issue of community disinvestment and community reinvestment. I have done extensive research on discrimination in lending. I have served as an expert witness in race discrimination cases involving access to credit. I have published extensively in the area. I have been consultant to state and local governments, regulatory agencies and community development groups.

Presently, I am working on a grant from the Ford Foundation to review the activities of groups involved in bank reinvestment activities. That research is not yet completed. I can, however, make some comments on the Community Reinvestment Act, the Home Mortgage Disclosure Act, the role of the secondary mortgage market, and the role of the regulators and community organizations in community reinvestment, based on my past experience and the interim results of the present research.

The HMDA and the CRA

First, some brief comments on the history of the HMDA and the CRA would provide a useful context for my observations. The HMDA was drafted in this Committee in response to community concerns about redlining, discrimination in lending, and the disinvestment by regulated lenders in older, minority, and economically distressed communities. As it was first proposed, the act included rural areas and commercial lending. It was called the Home Mortgage Disclosure Act only after these original proposals were deleted. In spite of its limitations, the HMDA has been used by citizens in over 100 communities across the nation in the process of reviewing the performance of local lenders.

I submit with my written statement a copy of a survey of HMDA uses which I did with Paul Scheraga in 1985. Since the HMDA was passed, we found about 340 uses of HMDA (Attachment #1 is a summary of that report), and comparable data, aside from the claims of regulators that they use the HMDA regularly in their CRA examinations and reviews. It is probably the most used set of public data aside from the census.

It is clearly one of the most used set of research data by community-based organizations.

Based on the 1985 survey, we estimated that there has been at least \$3.7 billion committed to reinvestment. Since the report was written, I would estimate that this figure has risen to about \$5 billion. In most cases, HMDA data served as a tool to initiate the negotiations which have led to these reinvestment agreements.

The CRA was also drafted in this Committee in response to community concerns. I can recall in 1975 when Gale Cincotta sat on the first mortgage lending commission in the country. I even recall one evening meeting when the President of the Federal Home Loan Bank of Chicago told that commission that while institutions were required to define a community to serve when they applied for a charter, there was no requirement and no review to insure that the community was served by the lender after the charter was granted. Moreover, he didn't see any reason to impose such a requirement. The drive for a community reinvestment act was born that night in Gale's astonishment and outrage.

Later, the South Shore Bank, in Chicago - a bank purchased to be a vehicle for developing the disinvested community of South Shore - pressed for some regulation requiring banks to serve their communities. As a result of the Chicago disclosure ordinance, which preceded the HMDA, the bank had discovered that the majority of community deposits were in large, downtown banks that were not returning anything but a minute fraction of those funds to the South Shore community. I believe that an early draft of the CRA emerged from a luncheon meeting between Ron Grzywinski of the South Shore Bank and Robert Kuttner, then a staff member to this Committee.

When the CRA was passed, it created an affirmative obligation for a lender to serve all the people within its community, with an emphasis on the needs of low and moderate income people. In the context of my remarks and my observations in the field, I would point out two things. First, that this affirmative obligation falls on each lender. It is not a passive requirement that the lender meet local credit needs if a person manages to fight his or her way through a maze of obstacles. It is an affirmative obligation for the lender to take the initiative. Second, the CRA designates the Federal financial institution regulators as the agencies empowered to enforce this Act.

You have heard a lot about CRA challenges and protests, and you will hear more. You have heard a lot about community efforts to enforce the CRA and to engage lenders in reinvestment activities, and you will hear more. But the CRA itself does not even mention challenges - or community organizations for that

matter. As Steve Rohde, a previous staff member of this Committee, pointed out at a reinvestment conference in Chicago this last November, the Act places all the responsibility for enforcement at the feet of the Federal financial supervisory agencies and places the obligations for service at the feet of the lenders themselves.

But, reinvestment has taken place almost entirely from the efforts of community organizations raising questions about a lender's performance, trying to work out a change in practices, and finally, when this fails, resorting to the protest or formal challenge process. The protest process is not something which was created with the CRA. In 1972, the South Shore Bank applied to move from this minority community in a Chicago neighborhood to a downtown location, five years before there was a CRA. As a result of several factors, including a powerful opposition from community residents about the potential loss of their only bank, this application was denied by the Comptroller of the Currency. Later the bank was purchased by the Illinois Neighborhood Development Corporation, and it began its saga as the best known development bank in the country.

The CRA mandates only that the record of community service shall be taken into account when a regulator reviews an application for insurance, relocation, merger, acquisition of assets, a branch office, or a charter. Community groups discovered that this language forced a formal regulatory review of a factor that had already been successfully used in denying an application. The protest, challenge and public hearing process already existed and was commonly used by one lender to challenge the applications of another. Once this right was made clear in the successful challenge of a New York City savings bank in the first year after the CRA was passed, the challenge process became the major point of leverage for community reinvestment activities.

#### Is Reinvestment Blackmail?

I point out this history because there has been a lot of publicity in the banking community and in the press about community groups using the CRA to "blackmail" banks into reinvestment agreements. I have attached a September 10, 1987, article from the *Wall Street Journal* (Attachment #2). This article quotes Edward Crutchfield, CEO of First Union Corporation of North Carolina, saying that the community groups' use of the CRA is "pure blackmail." The article casts all of the \$5 billion in reinvestment won with this Act as "concessions" which community groups have won from banks. The article reviews agreements for reinvestment from Wells Fargo and First National of Chicago as bad deals extorted from banks, and it depicts the

delay of the Hibernia Bank application from New Orleans as an act of harassment.

Finally, it suggests that a gift of \$30,000 to the National Training and Information Center in Chicago (a technical assistance and training center directed by Gale Cincotta) was extorted from First National Bank as part of \$500,000 in community gifts resulting from a CRA challenge. In truth, the proposal for these funds was first discussed over a year after First National made its reinvestment agreement. The funds are not part of the neighborhood development grants, which the bank is proud to be making. The money was given to NTIC because the bank wanted to do something for an organization that had engaged the bank in such successful community programs. In fact, the Chicago agreements have been such a successful partnership that the American Bankers Association, which has resisted community groups on CRA issues for years, published a glowing article about this partnership in the *ABA Banking Journal* the same month this article appeared in the *Wall Street Journal*.

The Wells Fargo commitment for \$41 million in housing loans actually proved to be so successful for the bank and the community that \$60 million was loaned out under the program. In the Hibernia case, the FED held a rare public hearing and took its time and made what it considered to be its toughest ruling in years because of the seriousness of the issues that had been raised by ACORN in this challenge.

The reporter who did this story talked to many bankers who were not quoted in the story, like Edward Williams of the Harris Bank in Chicago. These bankers were not used because they did not support the notion that the CRA was blackmail. So Crutchfield was used. If Crutchfield feels that he is being attacked by community people as his institution engages in a massive interstate acquisition campaign in the Southeast, then perhaps it is because of his own statements about the company's lending policies. In an article in the *New York Times* (March 22, 1987), Crutchfield boasts of his company policy to transfer funds from loans to securities when a new bank is acquired. It is no wonder that community groups in areas where First Union has applied to acquire a bank are worried and concerned.

In my own research, I have found that the blackmail seems to come from the other side. When a legal assistance program helped the NAACP chapter in Orlando, Florida, develop a challenge to an acquisition of a local bank by Citizens and Southern, from Georgia, this bank agreed to fly down from Atlanta and meet with the NAACP. But when the Orlando people got to the meeting they found that Citizens and Southern had brought with them the regional president of the NAACP. He told the local chapter that Citizens and Southern makes grants to the NAACP in Atlanta, and

to the Martin Luther King Center and that if the Orlando chapter did not withdraw its challenge, then it could lose its charter.

In my state of Minnesota, an interstate banking act was passed two years ago. Both of the major bank holding companies supported this law. But in order to get the law passed, they had to accept some strong reinvestment provisions, including a provision that any bank that makes acquisitions under the provisions of the law must set targets for making community development loans in each of the local communities of its Minnesota banks. The First Bank System and the Norwest Banks, the large holding companies that control well over half of all deposits in Minnesota, wanted to insure that these development loan standards were set as low as possible.

When the first application for an acquisition under the law came from Marine Bank in Wisconsin, there were enough comments filed to require a public hearing. One organization that had questioned the low level of development loans proposed for women was the Women's Economic Development Corporation (WEDCO), a nationally known program that helps women start small businesses. I conducted some research on the number of women in business in Minnesota and the community of the bank being acquired and went to the hearing to present this data, which supported WEDCO's concerns. But at the hearing, WEDCO suddenly withdrew its protest.

When I got back to my office I got a call from the person from WEDCO who had spoken at the hearing. She said that WEDCO had a proposal to get funding in Wisconsin and that Marine had made it clear to them that if they did not get the grant, in addition, she reported that representatives from the First Bank in Minneapolis had also made it clear that if WEDCO did not withdraw its protest that WEDCO would not get any more grant money from the First Bank. At the time, the First Bank was a major source of WEDCO's operating money - though the bank had virtually stopped making loans to WEDCO clients.

The Duluth Reinvestment Coalition filed a challenge against an application by Norwest Banks to consolidate several of its banks in northern Minnesota into two regional banks. Some people who wanted to make statements about Norwest policies and practices felt so threatened that the Coalition finally negotiated a private procedure for submitting statements from these people so that their confidence could be protected.

## The CRA Reinforcement: Games and Rules

Can community people really use the CRA as blackmail? My first response is that it is not possible to label as blackmail the exercise of the rights one has been given by an act of Congress. Second, in a practical sense, given the poor quality of enforcement by the regulatory agencies, it is hard to see how the lenders with even the worst records would fear a challenge. Not one lender has had an application denied since the first year of the CRA.

On the other hand, it is easy to see why community groups would resort to the challenge process. It makes a public issue of the lender's service to the community when all else fails. Moreover, it is about the only way community people have of getting the regulators to pay some attention to the CRA issues.

The normal examination and rating process has not been effective in "encouraging" lenders to reinvest in older, minority, and economically distressed communities. This introduces us to the first game. It is called "who got the bad rating?" The data submitted to this Committee confirms that over 95% of the lenders are given a rating of three or better, on a scale of five. Even the Consumer Advisory Council of the Federal Reserve System published a report in 1983 that questioned the accuracy and validity of these ratings (Consumer Advisory Council, The Federal Reserve's Implementation of the Community Reinvestment Act of 1977, August, 1983). Nonetheless, these ratings are used to protect a lender against a CRA challenge from the community.

In their response to the questions of this Committee, the regulators tried to tell you that they take these examination responsibilities seriously, especially as their work load on bank failures and failures of savings and loans declines. But, when I carry out my research and interview community people, they tell me that these examinations are a joke. I cannot do any research to see which lenders did well and which did not. I cannot compare the rating of any lender with an assessment of its performance because the regulatory agencies will not let the public know what any lender got as a rating. More than that, I cannot even discuss with lenders whether they think their rating was fair because the agencies have a policy against telling the lender its own rating.

That is like sending my child to school and then being told by the school that almost all the kids are scoring above normal on national achievement tests, but not being told how my child is doing and not even having my child being told his grades. And since I knew from recent research that over 90% of all school

districts in the country score above the national norms on these tests, even though we have a serious crisis of education and literacy, I cannot accept the accuracy of these tests. In my son's school, I know that they drill the students on these tests in order to beef up their scores. In the CRA exams it seems that the banks don't have to work this hard to rig up their score. The exams themselves are simply rigged so that no one can fail.

If all the lenders do so well, then I would expect that I could walk into almost any financial institution in the country and find good compliance with the CRA, and the HMDA for that matter, in all the areas where the public can assess performance. This includes posting notices in lobbies and producing statements and proper community maps and lists of loans the lender will make in the community.

Two weeks ago, I and my research associate and students from my banking class went to the five largest banks in Minnesota to check CRA and HMDA compliance. Not one bank was in compliance with both acts. First Bank, the largest lender, produced a lavish folder with a CRA statement and an HMDA statement, but both the CRA statement and the HMDA statement were from earlier years. The posters which are supposed to be in the lobby were hidden behind some dividers. At Horvath, the second largest bank, they were able to locate only the CRA statement. They could not produce the HMDA statement for 1986, and finally said that there was none and that there would be none. Marquette Bank told the inquirer that all the CRA files and records were kept at a distant branch location.

National City Bank sent me to an office down the street from the bank. It was the office of a mortgage banking company which is owned by the holding company of the bank. There, in another corporation, I found the CRA statement and the HMDA statement. The CRA statement claimed that National City Bank had given \$1 million to the Twin Cities Neighborhood Housing Services (NHS) program. It noted that an officer of the bank (who is now an officer of the mortgage banking company and not part of the bank anymore) was on the boards of all the local NHS programs. But further research showed that the bank had given only \$1,000 to the NHS and the HMDA records showed that the bank had not made loans in any of the NHS areas in the past several years. The fifth bank, American National Bank, could not locate its CRA or HMDA statements and finally resorted to mailing them out several days later.

Then, several of us went to one of those new banks located in a K-Mart store. In this case, the bank was Metropolitan Federal Savings Bank, which is regulated by the Federal Home Loan Bank Board. The main bank is located in Fargo, North Dakota, but it has branches across parts of Minnesota. There were no signs for the CRA, the HMDA, the equal Credit Opportunity Act or the

Fair Housing Act posted anywhere in the branch office in the K-Mart store. A kind, but confused man at the K-Mart office pulled a CRA statement from a drawer, but spent quite some time on the phone trying to find someone at the regional office or corporate offices who could tell him what an HMDA statement was. We then went to the regional office where another officer spent time trying to discover what these CRA and HMDA statements were all about. Finally, he said that the savings bank did not make mortgage loans, but that the mortgage banking subsidiary of the corporation did. Therefore, he did not have an HMDA statement. When he admitted that the savings bank does make home improvement loans, he still claimed that they did not have an HMDA statement. We could not see the public CRA file because we were in Minneapolis and the statement said that it was open for inspection at the main office in Fargo, North Dakota.

These are fairly common experiences for community people trying to review CRA and HMDA compliance. I have found that the cases where the CRA files were with officers who had been moved to another location or another corporation are not unusual. The CRA obligations are a task that gets dumped on one person, and when that person is moved, the CRA files go with him or her, even if that person leaves the bank itself. If you should be so unlucky as to go to a lender when this one person is out to lunch, or worse, on vacation, you are out of luck in your inquiries. Yet the regulators tell us that almost all lenders are doing fine.

The next game is a form of the television game Jeopardy, where you know the answer but have to guess the question. The answer is "a serious violation of the CRA." But what is the question you need to ask to discover that answer? How do you know if the lender you are evaluating has done something that is considered a serious violation of the CRA? If they have not, then all your efforts to build a case are a waste of time. You are already working in the dark. The lender has a rating, but you don't know what it is. The regulator has access to a lot of private information which you do not. So you have only a little bit of public data to help you. At least you expect that the regulator will give you some clue as to what is considered an important enough deed to warrant some action on the part of the regulator.

When people look at the results and rulings in challenges, they don't get much of an idea that there is anything that is considered a serious violation of CRA. Let me take an example from Minnesota, where we are known for corporations with a strong sense of corporate social responsibility. In 1980, the Minnesota Tenants Union filed a formal challenge against the largest savings and loan in the state, Twin City Federal (TCF), when it applied to merge with another institution. With some assistance, the Tenants Union engaged in a massive research project. They

examined the HUD data, and compared TCF to other lenders and compared the levels of lending in different types of communities. They looked at TCF's record of participation in government programs. From state and city agency records, and even from detailed studies of legal records, they examined the types of borrowers TCF served in these public programs. They examined census data and special studies to see what kinds of communities TCF served in its lending. They examined the advertisements for condominium conversion projects where TCF's development corporation was a partner with other investors in these conversions. They even used reverse phone directories to interview the renters who lived in these buildings before they were converted. Finally, they looked carefully at the Housing Assistance Plan in Minneapolis and the programs used to reach these housing goals. They even interviewed the public officials at the state and city agencies who created and operated these public housing programs, especially a City of Minneapolis mortgage bond program for low-income home ownership (called the ROP IV Program).

With the results of this work, they filed a challenge and were granted a hearing. At the hearing they presented a range of concerns about TCF confining its lending to areas where young, single professionals were moving in and replacing blacks and American Indians in inner-city communities. They were especially concerned about TCF's use of the ROP IV Program. The City of Minneapolis had not been able to reach its housing goals for family housing in several years and, as a result of a complaint filed by community groups with HUD, the City was placed under a special obligation by HUD to produce housing for these people. The ROP IV program was the main program designed to do this. It was projected to produce 400 units of small and large family housing for lower income people. But when the program was over, it had produced only 71 units.

The main problem was that the local lenders that originated these mortgages and then sold them to the City at a profit had used the loans for condominium conversion. The largest user of the Program was TCF. But only half they used the loans to convert rental housing to condominiums in general, but they had used the program specifically to finance conversions in projects which were owned by TCF's real estate development subsidiary. More than that, interviews of previous renters and records of buyers showed that many families had been evicted from the converted buildings, while almost all of the buyers were single white people who were low income only because they were in graduate school or had just completed college on their way to professional careers. In some cases, visits to the buildings during the conversion process revealed that the units were being marketed as graduation gifts from parents to their children because of the low downpayments and reduced interest rates on the mortgages. To add to this, researchers found that the marketing firm had

misrepresented the tax savings of ownership over renting in their brochures.

At the hearing, former Congressman and now Mayor of Minneapolis, Don Fraser sent a letter expressing his concern about the need for the City to be aided by all lenders in meeting its family housing goals. The member of the Minneapolis City Council who had created the ROP IV program testified about his shock and amazement at what TCF had done. Even the manager of the Program for the development agency submitted a statement complaining about what TCF had done. And what was the result of this? The Federal Home Loan Bank Board approved the application - without comment. The Tenant's Union filed another challenge against the next TCF application - got another hearing - and presented even more evidence. The result was the same approval without comment.

Community people in Minnesota were devastated. If this was not even serious enough for a comment by the FHLLB, then what was? No Minnesota groups got involved in CRA for almost seven years after this.

Finally, two years ago, the Duluth Reinvestment Coalition negotiated an agreement with the First Bank in Duluth, without a challenge. This last year, they finally filed a challenge against several applications to the Comptroller of the Currency by banks from the Worst Bank Holding company to merge groups of its banks into a few national, regional banks. Nothing is more fundamental to the CRA than the definition of a community to be served and the simple listing of the types of loans a lender is willing to make in that community. In the Mankato area of Minnesota, a farming region in the heart of the Valley of the Jolly Green Giant, Norwest was merging individual banks in Mankato, Albert Lea and Austin into a new regional bank. Bill Cain, my research assistant, compared the verbal descriptions and the maps of the individual banks to the new map and verbal description for the CRA community of the proposed regional bank. Attachment #3 includes the several CRA maps and a comparison of loans from the three individual banks and the proposed new regional bank.

Map "A" shows the total service area of all three of the individual banks aggregated together prior to the merger. Map "B" shows the map for the new regional bank's CRA statement, according to the verbal description. This community includes an odd lot of towns, but eliminates large farming areas between them. It also leaves out the cities of Austin and Mankato, where two of the banks are located. Map "C" represents the new map for the proposed regional bank. It includes all of the old service areas of the three banks and some more areas as well. So, what is the CRA community?



The table in Attachment #3 compares the types of loans listed in the individual CRA statements of the original banks and the loans listed in the CRA statement submitted to the Comptroller for the new regional bank in Mankato. In an area where farming is the main industry, all of the individual banks listed agricultural loans and all offered SBA loans and Farmers Home loans. In an area where many lower income people live in mobile home parks, two of the banks listed mobile home loans. But the new regional bank for this farming area eliminated all agricultural loans, SBA loans, Farmers Home loans and mobile home loans.

Another protested application was for two regional banks in the northeastern part of Minnesota, which has many low income American Indians and loggers and miners suffering from declines in those industries. Map "D", in Attachment 3, represents the CRA maps proposed by Norwest for new regional banks in northeast Minnesota. Area A defines the entire northeastern region of Minnesota. This is the community which Norwest claimed is served by their regional banks in an application to consolidate banks in North Dakota and in an application to consolidate banks in the northwestern part of the state. But in the two applications to consolidate banks into regional banks in this northeastern area itself, the applications only defined the two smaller areas indicated as area B and area C on the map. Regional bank B defines one area in the middle of this part of the state and another running from Duluth on the south up the shore of Lake Superior through the resort condominium areas, but not the areas between these territories or the areas to the north or south - which have large Indian reservations and populations of lower income miners and loggers. For some reason, they created a separate regional bank (bank C) between the two communities for bank B. But even here, they do not even connect these two little areas. The CRA guidelines for defining a community state that it should approximate a circle around a bank, or it should be based on such reasonable boundaries as townships or counties. Neither of these is the case in these CRA maps.

The community groups wanted to know if the Comptroller of the Currency, who was reviewing these applications for mergers, considered this an important issue. They could get no response. They eventually had to confront the Comptroller of the Currency himself at a speaking engagement in Chicago and come to Washington to complain to the staff of this Committee and the House Banking Committee. It took these monumental efforts and a letter from the legal counsel for the House Banking Committee to get a response from the Comptroller. Even when the Comptroller then agreed to hold a CRA review in Duluth in response to these pressures, the Reinvestment Coalition could get no response from the agency as to what questions they might ask in order to produce answers which would be taken seriously as possible violations. In fact, the examiner from the Comptroller's office

did suggest that there might be serious problems, but said that it was up to the community to ask the right questions to reveal them. The Coalition kept trying to divine the right questions, but somehow they were under the impression, from reading the law and regulations, that the Comptroller was supposed to ask these questions.

Again, these are common problems that I find around the country. When people deal with the regulatory agencies they cannot find out what would even be a serious issue if they could identify it. They find that the whole burden falls on them to find the right question and right data - even though the law says that the regulators are in charge of enforcement.

The regulators know what a bad job they have done. Last spring, I attended a conference on the CRA put on for bankers by the Cannon Financial Institute. There was one panel where representatives from all of the regulatory agencies addressed the bankers. In listening to the panel again on the conference tapes, I am struck with the many ways these regulators tried to let the bankers know that they should not trust in their high ratings to protect them. They were told that the examination process was going to get beefed up and that high ratings could be harder to get. Even at that time, they were told that these hearings we are at today would take place and that this would result in more pressure on the regulatory agencies to do a better job enforcing the CRA.

In the couple of months before these hearings, many of us in the field have noticed a sudden new interest in the CRA. The Federal Home Loan Bank in Des Moines has not had a Director of Community Investment for years. Suddenly I got a call a month ago from that bank asking for references for someone to fill this job, because "the Board in D.C. wants to get this going again." While no one from the Comptroller's office has ever contacted a community organization in years (except for a little flurry after the National Peoples Action and ACDW hit the Comptroller's office in Washington on separate blitzes about a year ago), suddenly the Comptroller is out in force trying to get input to CRA exams from the community. This is not easy because the Comptroller's Handbook for Consumer Examinations (as revised April, 1987) still tells local examiners to check with the Office of the Assistant Secretary for Neighborhoods, Voluntary Associations and Consumer Protection at HUD for lists of groups. Of course, this office was eliminated years ago.

In my city, my research assistant got a call from an examiner at the Comptroller's office. She asked him if he could set up a meeting with community groups in the Twin Cities that could tell her about unmet credit needs and the records of the five largest banks in the state. We are not a community group at the University of Minnesota, but we tried to contact as many

groups as we could in the five days we had before the examiner wanted to meet. As it turned out, we found that the examiner expected this to be the one and only community meeting in her examination of all five of the largest banks in the state. Moreover, she expected that the community groups would come and provide detailed written documentation of local credit needs and answer all of her questions at a single session. In essence, she expected a graduate research assistant to orchestrate all of her community contact work for examining these banks.

She was very disappointed when only a few community people could make the meeting on such short notice. She was even more upset when rather than giving her all the information she wanted, these people told her that if she wanted to get community input, she would actually have to go and meet with the groups - and that what she could expect from those who had come to the meeting was a better list of who these groups might be. People pointed out that there are over 150 community groups in the Twin Cities and about 20 groups with established records in housing and economic development. These groups have done considerable research on access to credit for this work, but those present refused to act as representatives of people who were not there.

A good part of the meeting dealt with how the Comptroller could identify active community groups in the future. As it was, the examiner had no idea how she even got the name of Bill Cain, my research assistant whom she contacted as the key person to set up this "community" meeting. I suspect they got his name from his request for a copy of an application for some research we were doing. Whatever the problems of the past, people were willing to help the Comptroller set up a decent process of communication in the future. The people who were at the meeting impressed upon the examiner that this certainly should not be listed in her report as having met with the community. But the examiner was only interested in getting what she could for her examination reports - which had to be done in two weeks. No further effort, it seems, was made to contact community people.

Most of the rest of the meeting focused on the Jeopardy game as people tried to get from the examiners who had come some idea of what an important issue would be. It was a futile effort. What they did learn is how little examiners know about the banking structure. The examiner told us that she was part of a new and much more aggressive examination process. When asked why she had suddenly come to the community at this time, she told us that the orders came from Washington. When pressed further, she said, "Congress has a Division of Banks, you know, and they can tell the Comptroller what to do." While we were amazed to discover this previously unknown division in Congress - and perhaps it is a surprise to all of you on this Committee as well - we can be sure that the order came from Washington to get out in the community and make it look like the Comptroller is doing a

better job. If this represents the new level of enforcement, one shudders to think what the old level was really like.

Meanwhile, community groups have used the flurry of CRA covered applications resulting from deregulation and interstate banking as an opportunity to get some more lenders involved in community reinvestment. While there is little confidence among community groups that regulators have the courage to use the CRA process to actually deny an application, the public embarrassment the challenges cause for the lenders is a powerful force for change in banking practices. While the regulators can't seem to explain what would be a serious violation of the CRA, when the lending practices of institutions are exposed to review in the media, the general public does seem to be able to form an opinion about what is a poor job of lending.

It is this publicity lenders really fear. As we have seen, in some cases, the banking industry has been able to find members of the press who will write articles charging the community groups with blackmail. But generally, when these issues come to light in the local media, the reception is not so kind. The lenders, however, have recently been able to get the regulators to make various ad hoc rules and decisions which help keep reinvestment issues from the public eye.

Here are some of the new rules of CRA:

1. There is the Tamey Bell community majority rule. Eight organizations from four states challenged an application of First Interstate, from California. This represented the largest number of different groups and the most number of states ever involved in a single challenge. But people at one meeting with Tamey Bell, the Community Affairs Officer of the San Francisco FED, report this rule. Bell told them that it was hard to take the challenge seriously because First Interstate serves over 90 communities and only eight filed a challenge.
2. There is also the Tamey Bell public meeting rule. The protest processes for all of the regulators provide for public meetings in cases where the issues need elaboration and clarification beyond the written claims of both sides. In earlier times, when only banks challenged banks and public hearings did not attract the media, such hearings would be held in cases where there was a serious issue. These hearings are a means of bringing a lender's record to public view. Some people involved in the First Interstate challenge report that they were invited to a meeting with Bell only to find out when they got there that the bank was also asked to attend. Of course, they were unprepared

for this type of meeting. They report that Bell declared that no public meeting was required because this private meeting had taken its place.

The other agencies seem to have adopted this rule, as well. They are willing to go to all kinds of extremes not to have a public meeting. They hold private meetings. They have even, in some cases, initiated a CRA review of a lender and invited the community groups to participate in that process, in lieu of a public meeting.

3. The Tamm Bell private meeting rule is very close to the Sid Sussan rule on extensions. Extensions can be granted to the 10-30 day comment period which follows an announcement by a lender of an application for some privilege covered by the CRA (i.e. an acquisition of another holding company, a new branch, etc.). The rules for comments require that any comment and any protest or challenge - and any request for a public hearing - must be made within this comment period or it will not be accepted. Several groups have reported that comments that they had not been able to get to the regulator until a day after the deadline were ruled out of order. Extensions were a common practice in earlier years so that community groups could prepare their case in more detail and so that issues could be resolved by the parties involved without a formal challenge being filed.

Sussan ultimately makes all the decisions on extension requests for the FED. But in the last two years, he seems to have denied almost all such requests. Sometimes groups never get a reply to their requests. Other times officers of the FED meet with groups and get additional information, but without any formal extension. It is all controlled very tightly by the FED. This rule and practice also seems to have been adopted by the other agencies.

4. There is the HMDA evidence rule defined by Community Affairs Office of the Philadelphia FED. This rule states that no matter what the analysis of the HMDA shows, it cannot be considered as enough evidence to rule against an application. This means that one of the only pieces of data that a group can get about a lender cannot, in itself, support a case against an application being approved. After all the years community people have fought for the HMDA and all the times they have labored to analyze the data, it is ruled inadequate out of hand - regardless of what it shows.

5. The Atlanta FED race rule expands on the HMDA rule. Here, particularly in the case of the applications by Hibernia, in New Orleans, and Trust Company, in Atlanta, the FED ruled that even extreme patterns of disinvestment in minority communities were not adequate grounds for the denial of an application. In the Hibernia case, the FED did require Hibernia to engage in practices to improve its lending - and even to work with ACOBN, who had filed the challenge, in these efforts. But then the FED refused to allow ACOBN to see information about what Hibernia was doing and what they were required to do.

In the case of Trust Company, in Atlanta, the Atlanta Reinvestment Alliance had shown that Trust Company had almost no loans in the minority communities in Atlanta, even though these communities represent a large part of the population. Trust Company responded that they had chosen to offer only one type of mortgage product and that this product was appealing to higher income, mobile white populations, but not many blacks. Admitting that this product discriminated against minorities, Trust simply asked the FED not to apply the effects test in considering discrimination in this case.

Trust had developed a special mortgage product which would appeal to people in lower income communities, but prior to being challenged by these community groups in the last year, Trust had made only two of these loans. Finally, Trust refused to advertise these loans in the local media because, as Trust put it, that would generate a lot of applications. Trust had no loan product that might be appropriate for middle or upper income blacks in stable communities.

The FED approved the application without any conditions. In defending this ruling, the FED noted that Trust intended to become involved in a program to make \$10 million in loans for multi-family building in a consortium with nine other major lenders in Atlanta. The plan fell through after the application was approved.

6. There is the South Bank rule that no application will be turned down unless there is a challenge. While practice has shown that no application is denied for any reason, the regulatory agencies base their reviews on the CRA ratings. There had been no case where it was clear that the lender had a bad CRA rating and still got an approval. All that changed with the South

Bank in Chicago (not to confused at all with the South Shore Bank in Chicago).

This bank had been given a bad rating. It was so bad that the regulatory agencies had contacted all kinds of development programs and community groups about what they might suggest to the bank to get it to reinvest. The agencies had delayed approval of applications for some time. They even encouraged groups to file a challenge. But finally, because there was no challenge, the FED approved the application to allow the bank to create a one-bank holding company. This bank's record was so bad, however, that there was actually a split vote on the Board of Governors, with Governor Rice strenuously objecting to the approval. To community groups, the decision was a clear admission that if you don't file a challenge no application will ever be denied.

7. Finally, there is the no penalty for bad HMDA reporting rule. This is simply an attitude that it doesn't make any difference if HMDA data are reported properly. While the level of bad reporting has become very low, some lenders still fail to fill out the HMDA properly. One error is lenders that report condominium loans under the multi-family loan category. An example of another, more systematic problem, comes from working on several years of HMDA data for Atlanta. I noticed how, for a few lenders, the HMDA computer tapes from the regulatory agencies in Washington indicated a large number of loans which were not properly reported. Therefore the government agency knew of the errors. Yet in succeeding years, the same lenders made the same errors. Obviously no one cared and no penalties were imposed, so why should the lender bother to comply with the law.

The Veterans Administration has never required its lenders to disclose their lending. HUD was disclosing where its lenders made loans under the provision of the HMDA that required the Secretary to produce data "in his possession" that was comparable to the HMDA. But HUD discovered that simply by not collecting such data any more, it would not be in HUD's possession, and therefore did not need to be disclosed. So, for years, there has been no HUD data.

## Changes in the Banking Industry

Prior to the recent onslaught of interstate banking activity, the deregulation of the banking industry already introduced trends which posed problems for community economic development activities. On the single-family housing side, high interest rates in the late 1970s put an end to many CRA activities and lender challenges, especially in the savings and loan industry. With no way to make loans affordable even if they were committed, a great deal of CRA activity came to a halt. But part of the problem with both the savings and loan industry and the high interest rates for housing was deregulation. At this time, most savings and loans held the majority of their loans in the portfolio. Federal regulation allowed savings and loans to pay slightly higher interest rates than commercial banks, in order to attract savings - which had to be used in housing lending. Yet the costs of these loans were kept down by the relatively low interest rates paid on all savings accounts. When lenders were permitted to offer money market accounts and compete with other financial institutions for deposits by raising their rates to full market levels, the cost of funds (deposits) went way up. Therefore, the cost of loans went up to keep a positive spread between what lenders had to pay on deposits and what they charged on loans.

Savings and loans, however, found themselves with a large portfolio of old loans at low interest rates while they had to pay higher and higher interest rates on their savings accounts in order to compete for deposits. Not only did this precipitate a crisis in the savings and loan industry, but it created an incentive for savings and loans to stop holding their loans. They began to invest in housing by investing in secondary mortgage notes while selling off their own originations in the secondary market as well. This made them more liquid and more resistant to changes in interest rates, but it also insured that mortgage interest rates would float at the full market rate in the future (unless mortgageholders had sufficient resources to pay a large number of points to reduce the effective interest rates).

The increased cost of borrowing, based on the increased cost of funds - based on increased interest paid on deposit accounts - has helped to keep interest rates high. Another effect of the high costs of funds has been increased competition for these funds. This has resulted in a reduced spread between what lenders pay for their deposit funds and what they charge in interest, as they compete in both areas. In order to respond to this reduced spread, and thus reduced profits, lenders have sought to streamline their transaction and operating costs, or to charge fees to cover these costs. It is only in the extremely

competitive areas of seeking deposits from "upscale" individuals and institutional customers and in making large corporate loans that lenders have tried to reduce costs and fees in order to attract as much of the market as possible.

For community development activities, this encourages lenders not to engage in smaller loans and transactions which may require more work in relation to the loan size. The impact in the housing markets has been to expand a range of mortgages, but to raise the entry requirements for borrowers on both the credit quality and housing quality side. Loans must easily meet the standards of the secondary mortgage market - standards which are set largely by the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac). These are what FNMA calls "plain vanilla mortgages".

On the commercial and business lending side, this means seeking out either large loans, or loans that do not require much time to process and that have large and easily recoverable collateral assets pledged for the full value of the loans. For economic development activities, this means problems in loans for new or troubled businesses (where time and skill are needed to underwrite the loans), and problems in small loans and loans without full pledges of collateral.

Technology represents one way of increasing some bank services while cutting down costs - such as in taking deposits and giving out cash through electronic transfer machines (cash machines). This can reduce transaction costs, but at the expense of people who may need personal service. The use of technology and computers also encourages further standardisation of services and products to comply with computerisation and information processing and evaluation needs. Again, this works against the hand-tailored needs of community economic development activities.

Increased competition, the need to reduce costs, and the use of communications technology also help to move funds in what economists call more efficient markets. That is, funds flow more rapidly and more effectively from areas of capital excess to areas of capital need (defined as areas of stagnant or declining economies and areas of growth). This happens not only in local areas or regionally, but nationally and internationally. By definition, areas needing economic development are these stagnant or declining areas that now lose funds more effectively and more efficiently.

The advent of interstate banking further reduces the regulatory structure which holds money in certain areas and regions of the markets. Thus, it provides the same incentives and disincentives as deregulation in general. On the other hand, while deregulation tends to create changes in money flows through the existing banking structures, interstate banking also makes

changes in the structure of the banking system itself. As banks and bank holding companies are bought and sold, the banks which exist in a local community are themselves changed. We know that one of the key aspects of access to credit and access to development finance is the management philosophy and attitude of different banks and banking companies. Thus, as the banks change ownership, even within the overall more constant forces of deregulation, the flows of funds are also altered by these changes in who controls the assets of the financial institutions.

Changes are also created as institutions prepare themselves to buy others, to sell themselves, or to ward off purchases by outside institutions. All of these options encourage lenders to seek ways of increasing their capital. This creates the same incentives for streamlining, cost cutting, and competition for the most lucrative markets that are created by the deregulation process.

Finally, there have been some huge losses in both the savings and loan industry and the commercial banking industry. Some members of the savings and loan industry are still suffering from the effects of the squeeze between existing loan portfolios with low interest mortgages and high interest rates on their deposits. The commercial banking industry, having recovered from losses in real estate investment trusts in the mid-1970s and losses in energy loans in the early 1980s, is reeling from losses on foreign loans, new losses on energy loans, and losses on agricultural loans. The rate of bank failures is the highest since the Depression. All this, too, tends to make lenders more conservative in their lending, though some banks are making record profits.

#### Disinvestment, Demand and Development Banking

The most critical question that gets asked in this whole reinvestment process is whether there are unmet needs and unmet credit and service demands in the community. It is the question of how far a private lender can and should go to get involved in community development. What is the role of the lender and what are the limits of this role? As a starting point, I am reminded of a quote from a banker I interviewed several years ago in a rural area. He said, "If you want to know how the local banker is doing, look at Mainstreet. Mainstreet is a reflection of the local banker."

This comment was more perceptive than one might imagine. Here in the United States we have defined a very limited role for lenders in public policy in community and economic development. Their job is to make money for their stockholders and to protect the money of their depositors. In every other part of the world,



whether it is the banks in Japan directing investments into the development of future high tech industries or whether it is a lender in Bangladesh making tiny loans to individual women to help them create one or two persons businesses as a means of survival, the role of lenders in the process of economic development is seen as a central issue. In the United States, we recognize the need for a World Bank and for our banks to become involved in the development of third world countries - even when they lack the familiarity with those foreign cultures and conditions to make sure their investment are sound. But, aside from the provisions of the Community Reinvestment Act, we define no such development role for lenders in the United States.

Inner-city communities, many rural communities and small towns are really third world economies in the midst of an allegedly healthy and growing economy. They have the same development banking needs as any other place in the world where the economy is distressed. Yet, by the very definitions our economists place on need and efficiency in capital markets, investment in these declining areas is seen as anathema to sound business practices. "Commercial Credit and Rural Economic Development" (Boggs, Bradford, and Duncan; Mountain Association for Community Economic Development, 1984) includes a general literature search on banking and reinvestment. It finds that because of the definitions economists use for efficient capital markets, the process of disinvestment is seen as a good thing for the capital markets and the banking industry.

That is, money is supposed to flow to the areas of high demand, defined as the areas of high growth. Capital is to move from capital surplus markets, where there is more capital than there is demand, to capital short markets, where there is not enough capital to support the growth. By this definition, for example, the literature on interstate banking, which has been largely the product of the Journals of the various Federal Reserve Banks, claims to show that interstate banking has made the capital markets more efficient, partly because it has moved the capital from declining rural and older communities into the growth areas. While this makes some sense to the voodoo mentality of economists, it literally defines the problem for economic developers.

By the models of the economist, people would be crazy to invest in declining areas. Thus, they are encouraged to take the deposits of people in declining areas and move them to growing areas and upscale markets. Of course, the very process of withdrawing money from a community, further adds to its decline and thus creates even more incentive to withdraw more credit. This process of the spiral of decline initiated, or at best, accelerated, by disinvestment contributes to economic decline and makes it a self-fulfilling prophecy. When the reinvestment movement began in the 1970s around redlining, community people

focused on the role that racial change played in this disinvestment process. The main issue was how race was used as an indicator (falsely, of course) that decline would take place in a community. Lenders used this indicator to withdraw credit. The withdrawal of the credit made it even harder for homes and businesses to be maintained, so this disinvestment by the financial community contributed to physical and economic decline in the community.

This was the process of redlining. But we have known for some time that race is not the only factor that precipitates disinvestment. The desire to make the capital markets more efficient encourages disinvestment in any community where the economy may be temporarily weakened. Once begun, the disinvestment can become the cause of further decline. Every economist seems to know that decline defines a capital surplus market, while every economic developer knows that decline defines a community in need of capital. We have a difference of cultures and attitudes - and the banking community in this country has been encouraged to live by the culture of the economist.

In the early stages of decline, simply opening up access to credit can be enough. But as a community declines, the institutions, businesses, and actors necessary to turn access to credit into improvements in the quality of the housing stock, physical development, and business development have also withered away. Without an effort to rebuild these institutional capacities, simple access to credit is not enough. The result is structural disinvestment.

In the case of structural disinvestment, development banking is required. Development banking involves not only creating access to credit, but helping to build the structures and capacity to get the credit out into viable development projects. This role requires just the kind of affirmative attitude that is defined in the Community Reinvestment Act.

Let us understand that demand is not simply a natural force of the market, it is a product of market development. Lenders do not sit and wait for demand in deposit products, they compete, almost desperately, to develop demand in the upscale communities where they think they can attract the largest deposits. No one can look at the advertising programs lenders use to develop deposits and think that demand is a natural phenomenon. In the product development as much as by any natural market process, and you will see that the number of credit card solicitations you get the many extra programs and services the lender tries to develop to get you into debt through your use of that credit card.

On the development banking side, the same is true. Communities can be served where proper products are developed to serve them. This may simply be making it known that a lender will grant access to credit. This is the case in race discrimination, where the only barrier is ethnicity. But where the housing stock has deteriorated, in addition to credit, one needs local developers capable of rehabilitating the units in creative ways that preserve the housing stock for people in the community. In areas of business decline, this means assisting entrepreneurs in locating markets, locating appropriate space, developing sound business loans, and developing programs to train community residents to be part of the work force. These other resources are necessary to build the capacity to insure that the credit flows into sound loans for the lender and productive loans for the community.

#### Is Redlining Dead?

Before moving on to a discussion of how reinvestment takes place, I feel a need to make a comment on redlining. Redlining was the issue which first fueled the neighborhood reinvestment movement. It was not so much a question of development lending as simple access to lending. When the first hearings were held on the Home Mortgage Disclosure Act, this committee room was filled with community organizations from all over the country who spent two days outlining how redlining existed in their communities. As you recall, Mr. Chairman, redlining by lenders was later traced to redlining by insurance companies and then by the secondary mortgage market.

All of the people who have been involved in the reinvestment movement over the years, recall the effort that you, Senator Proxmire, put in to tracking down how discrimination was written into the policies of Fannie Mae and Freddie Mac. By the end of 1978, you had been able to get both FHMA and Freddie Mac to make major revisions in their underwriting policies in order to eliminate factors and policies which were discriminatory in effect and practice. Both agencies adopted detailed statements recommended by your staff that defined in detail what redlining was (both in its overt and more subtle forms), described examples of how it worked, and made clear what was to be done to eliminate it.

Since then, there has been some rumor that redlining no longer exists. Much of this has been fostered by the work of economists like George Benston, working under grants from regulatory agencies and members of the banking industry - often distributing his work through the publications and conferences of the FED. It is his work which claims to have shown that

redlining is, and was always, a myth. He did this by two means. First, he created a straw man by choosing only a few of the studies of HMDA and other studies of mortgage credit data that were weak in methodology. In doing this, of course, he ignored the massive amount of literature on the other side. Second, Benston, and other economists who have written about the myth of redlining, all seem to share an interesting view of research. They all assume what they claim to be testing. That is, while they claim to be testing to see if the clearly different lending patterns they all find between white and black communities are due to discrimination, they use the difference in lending patterns itself as proof of the higher risks in black communities.

Generally these economists lack any data on risk and foreclosure. Sometimes, they actually have data that suggest lower risks in minority communities. This is the case in one Benston study, for example, where whites in a Rochester suburb actually paid higher percentages of their income for housing than did blacks in that city. Based on what we know of the predictors of foreclosure risk, this would make the whites a higher risk. Yet Benston's own study shows that the whites had access to conventional lending while the blacks were confined to a market of government insured loans. In trying to explain the difference, Benston simply assumes that no lender would require insurance if it was not required. Therefore, he uses the fact that blacks had to use government insured loans as proof that their confinement to government insured loans was required by risks - not race. Generally, I have found that those who espouse the myth of redlining depend upon this circular logic.

In 1984, about three years after the time Benston was writing about the myth of redlining, based on a very small sample of the literature, I made a listing of the literature on race discrimination in lending for use in a lawsuit on discrimination in credit. Many of the items were Congressional hearings and government reports. There were almost 200 listings at that time. Since that time there have been even more studies of lending patterns and race. Personally, I find many of the community studies to be of high quality and quite sound. But, for those who require that a study be done by academics and trained researchers, there have been detailed and sophisticated studies by academics, including myself, and research centers, such as the Woodstock Institute, in Denver, Washington, D.C., Chicago, Philadelphia, Baltimore, and, most recently, in Atlanta. The patterns are as clear as ever that race is major, and typically the major, factor that explained lending patterns. In the recent study done by the Atlanta Constitution/Journal Charles Finn and I worked with Bill Dedman, the reporter who did that study. This study carefully controlled for income and growth. It reviewed patterns over several years, during times of very different

national economic conditions and mortgage markets. Yet nothing explained the different lending patterns as well as race.

All this is important in emphasizing that race is still a major issue in lending and in CRA processes. But it is also important because FHMA and Freddie Mac seem to have decided that there is no longer any such thing as redlining. Both agencies eliminated almost all of the anti-redlining language that community people, the Justice Department, and this Committee worked so hard to get into their guidelines. This last year, when National Peoples Action and ACOORN groups met with representatives of FHMA and Freddie Mac, there wasn't a single person from FHMA who even recalled those 1978 changes. There was only one person from Freddie Mac who recalled that anti-redlining language.

But the National Peoples Action leaders did remember. And an embarrassed staff of FHMA finally agreed to place some of these provisions and prohibitions back into their guidelines. FHMA has now come up with some more revisions, just in time for this hearing. Freddie Mac has been less responsive, and generally only agreed to think about this issue. In both cases, while some progress has been made, much is left to be done just to get back to where the community groups and this Committee had brought the secondary market ten years ago.

#### Attitude is the Key

What is the key to change in the lending community, the secondary mortgage market, the private mortgage insurance market, and the investment community in general? The key is in changing attitudes. This was the central theme of the research paper "Commercial Credit and Rural Economic Development", referenced above. The attitude of the management of a lending institution, urban or rural, is the key factor in whether that institution engages in non-discrimination and development lending.

Bank size, bank structure, the condition of the local economy are all assumed to have major impacts on credit markets according to economic theory. But the studies that actually examined the attitude of bank management as well show that this last factor is more important than any of the others. Indeed, a study of the banks in West Virginia by the Mountain Association for Community Economic Development and a research team from West Virginia University is being published this month. It was designed to test this precise issue. The results demonstrate, again, the dominance of management skills and attitudes over any of these economic and structural factors.

The CRA, of course, was created specifically to deal with changing attitudes, by encouraging lenders to serve the needs of their entire communities. Indeed, all of my experience in this area attests to the effectiveness of the CRA in changing attitudes - when it has been used. The \$5 billion in reinvestment agreements represents changes in the attitudes of lenders attitudes about markets and demands in older, minority, and economically distressed communities. The increasing success of these programs in getting productive lending into these communities attests to the effectiveness of changed attitudes.

Of course, in the area of development banking, changes in attitude must be accompanied by development of programs to build the redevelopment capacity back into the community. This is what has been happening in the more recent reinvestment agreements. The \$500,000 in grants from the First National Bank of Chicago, is not blackmail. It helps to build community capacity from packaging business loans to fighting the high crime rates that undermine both business and residential security.

#### Community Action and Reinvestment

While there have been many successful reinvestment agreements and programs across the country, and while some community groups and banks have been able to move from one reinvestment agreement or program to another in a spirit of cooperation and partnership, there is no evidence that there has been any collective historical growth in these relationships. The need for direct community action has not diminished - indeed, it has increased as concern for economic development increases and as communities perceive the need to secure financing from the private sector at a time when the regulatory and banking environments are changing in ways that discourage participation in community economic development.

Interstate banking has created more applications covered by the CRA than ever before. Essentially, the community action groups are using CRA-covered applications, largely from interstate banking acquisitions, as a means of forcing the regulators to review the CRA records of the banks. In a large number of cases - possibly even the majority - community action groups have engaged lenders in negotiations outside of a formal challenge process. Not only are there more applications, more before, but the process has become extremely more complex from the community side.

When the CRA was first passed, most community groups were concerned about single-family, and maybe multi-family, housing needs in their local communities. Their local lenders might

engage in applications for relocation of an office or for a branch office, but generally they always had the same lenders to deal with and they could develop a familiarity with the lending policies and even the lending officers of each institution.

With the advent of interstate banking all this has changed. Most often, now, groups are faced with a new lender coming into a community from another area, not just another part of their state, but from another state. The ACOBA chapter in Phoenix, for example, finds itself facing applications from banks from New York, Minnesota, and California. In order to evaluate the performance of that bank, they need information about the local lending patterns of a bank sometimes located several thousand miles away. They need to know if this bank, which they have never dealt with, and in some cases never even heard of, serves its local communities well in the state where it comes from. There may or may not be community groups back in the home state of the lender that can respond to this question.

Even if they are able to assess the record of this incoming lender, they may have to deal with a regulatory agency in another region of the country. When Chase Manhattan applied to buy a bank in Phoenix, to use the same example, the application was to the FED in New York, not the local FED in San Francisco which covers Arizona. In the case of Chemical Bank in New York acquiring Texas Commerce Bank, different individual groups in Dallas, San Antonio and New York City all became involved in the application, which was again to the FED in New York. This required contact and cooperation among community groups in both states and among all cities. Eventually the negotiations involved officers of the FED in both states, as well.

In other cases the acquisition of a holding company is accompanied by applications to consolidate the banks of the holding company being purchased with the existing banks of the holding company making the acquisition. For example, when Horvest Bank holding company, from Minnesota, buys a holding company in Cedar Rapids, Iowa, it applies to the Minneapolis FED, but then it wants to merge this Cedar Rapids bank with its own Horvest Bank in Iowa, which it owns from previous interstate activity. So, Horvest applies to the Comptroller of the Currency for this merger. Citizens for Community Improvement in Iowa has been trying to work with Horvest on farm lending issues and in as much as they have been rebuffed by the holding company, they want to file a challenge to this acquisition and merger. They now have to deal with two regulatory agencies, one in Minneapolis, and one in Kansas City (each with the different regional districts and each with different time periods and processes for challenges and extensions of the review and comment period).

Add to this the concerns of two groups in Minnesota, the Duluth Reinvestment Coalition and Minnesota COACT. These groups have also been trying to deal with Horvest on its applications to consolidate its Minnesota banks into a few regional banks. This already involved filing challenges to the Comptroller of the Currency on 5 of these applications for mergers of Horvest's own banks. Now these Minnesota groups discover the application by Horvest to make the acquisition and merger in Iowa. They file a challenge here again, this time to the FED. Then they begin working with the groups in Iowa - not only for coordination but to see what kinds of agreements are made and to insure that agreements in one place do not get the lender off the hook on making agreements in another place.

These cases are not as unique as they may sound, and they are becoming the norm. Then, add to this the need to develop a housing development and economic development capacity in order to implement the CRA agreements which might come from these challenges.

On top of this increased complexity, the regulatory agencies have imposed another game. It is a version of the old abbot and Costello routine of "Who's on first?" It involves sending people to different officers, sometimes in different agencies, to get information or deal with an issue about an application. In my area, when four community people called our local FED to get information on the deadline for comments on an application, they were sent to four different people - from the Community Affairs Office, to different people in Bank Supervision, to a person in Washington. They got three different dates given to them as the deadline for comments. In the FED, people are usually steered to the Community Affairs Office, yet it is the banking supervision department that makes the actual recommendations. All this adds confusion to an already complex and frustrating process. The short comment period deadlines, combined with the ad hoc no extensions rule, can create a near panic mentality as community groups find themselves directed to several different people and several different offices for answers to their questions and responses to their concerns.

Even where there is no challenge, this need for sophistication in developing the implementation of agreements exists. This involves either developing a capacity within existing groups dealing with the bank, or finding some outside resource to do the development work or to work with the local businesses to insure that the money goes out into the community after the agreement is made with the lender. Increasingly, we find that groups must contend with both the implementation issues of complex housing and economic development agreements and with the issues of dealing with multiple challenge or negotiation groups and even multiple regulatory agencies.

All of these problems exist within the confines of the challenge process, if a group is forced into that mold. This means that all this seeking of information, analysis of what is discovered and all the contacts and initiation of some form of cooperation or coalition process must take place, to some degree, before the 10-30 day deadline for filing a comment or a challenge. Of course, this is after the group finds out there is an application, which often takes some time since the applications may be filed with various regulatory agencies all over the country. Usually, a group loses several days in the comment period before they discover that an application exists.

There was a time when a regulator might have claimed that these comment and challenge periods were adequate, if proper and clear notification was received early. After all, they typically involved a local institution with which a group might have been expected to have developed some contact and some relationship well before the time of the application. But this is surely not the case in interstate banking. First, the level of activity is so high that some groups have all their energy sapped just tracking the applications and deciding what to do about each one. Then, they need to know not only the record of the local institution, but the record of the acquiring institution from many states away.

Some have argued that there is no need for this panic, because the level of activity is so high that there will always be another opportunity, but community groups cannot count on that activity. More importantly, if no challenge is made, the regulator is going to give the lender a clean bill of health on its CRA performance, and this will work against any future challenges by the community. To make things worse, challenges already require one regulatory agency to essentially critique the CRA review of a lender given by another agency - a process which regulators seek to avoid - especially in the CRA area where they do not feel confident about challenging high ratings and setting performance standards.

Finally, in order to make many of the reinvestment programs work, there needs to be some sort of public resources and programs to provide subsidies, guarantees, and incentives for lenders to get involved in housing and economic development activities. With the withdrawal of Federal funding, groups must turn to the state agencies and to the state legislatures to develop these carrot and stick laws and programs. This requires creative program development, often hand-tailored to the needs of each state and its political and fiscal environment. It also requires an intervention process related to the legislative cycle and process rather than the application and challenge cycles and processes. It requires some understanding of banking laws, and their variation from state to state, and a whole range of possible and existing economic development program activities.

In addition, it requires some understanding of existing and alternative capital and credit markets and institutions so that critical gaps can be filled and so that existing capital and credit markets can be called upon to play their role whenever it is possible.

#### Conclusions

The result of all the behavior and activities I have described is that even though they are not mentioned in the Act, community-based organizations carry the load of enforcement under the Community Reinvestment Act. They are given less and less information that regulators will accept as making a case for denial. The VA, HUD, and the secondary mortgage markets do not provide HMDA disclosure, and some lenders still fail to report their loans properly.

The regulators admit that their own ratings are open to questions, but they will not make them public - precisely for that reason I imagine. Even if a community group presents powerful evidence of discrimination or a bad service record, nothing seems to be considered an important violation of the CRA.

And finally, it becomes clear that the regulators will not carry out their enforcement responsibilities unless they are made to do so by community groups - who, of course, will be criticized for aggressive behavior if they do file a challenge.

In spite of all this, community groups have increased their efforts to gain reinvestment. They have negotiated billions of dollars in reinvestment at not one penny of cost to the Federal government. They have built successful partnership with lenders - and together with the lenders they have developed an entire development banking industry in this country. We now have banks involved in community development corporations with community groups. We have at least one development bank subsidiary of a multi-bank holding company. We have an extensive network of trained and accomplished development agencies that can rebuild the development infrastructure in disinvested communities.

Wherever community organizations have committed themselves for the long haul of reinvestment work, the attitudes of lenders have been changed and reinvestment work has begun to take root.

But these groups need help. The Community Reinvestment Act can be a tool to change attitudes and create new possibilities, but these potentials are severely limited without the Federal regulatory agencies doing their jobs. Community-based organizations and an increasing number of local governments that



are getting into the reinvestment process are operating at full capacity trying to do the development and community building work. They have made tremendous gains. They have defined an entire new market of development banking with its own skills, challenges, and accomplishments, but it will be hard to keep moving forward if they have to carry the full weight of the regulatory agencies on their backs.

#### Recommendations

I would make the following recommendations:

1. Commercial loan disclosure and the disclosure of deposits and agricultural lending must be added to home mortgage disclosure data. This will allow citizens to track participation in development banking.
2. The CRA ratings should be made public, with published statements by each supervisory agency stating why that rating was assigned to the lender.
3. In rating lenders, the supervisory agencies should rely on model reinvestment agreements and profiles of model banks in setting the standard for high ratings. This would set the top standard at the cutting edge of the field of development banking, where it belongs. The profiles and catalogs of model reinvestment programs should also be made public and revised each year. It should be made clear, however, that actions to overcome discrimination are actions to conform to the law. They are not to be considered as development banking activities.
4. HUD and the VA should provide disclosure for their loans, as should FHWA and Freddie Mac. In the case of FHWA and Freddie Mac, they should also provide data on their multi-family purchases.
5. The Federal supervisory agencies, in their CRA exams, and in developing models of performance, should specifically require lenders to state what they have done in the area of overcoming discrimination in the credit markets and in engaging in the field of development banking. These agencies should encourage the creation of development lending offices, programs, and development banks and development corporations within lending institutions and between lending institutions and community-based groups.

6. The rules for filing challenges should be changed. Comment periods should be lengthened to at least 60 days, with clear provisions and standards for extensions when more time is needed for productive research or negotiation. The public hearing process should not be denied without clear justification that it could serve no purpose.
7. Better public notification processes are needed to inform people of pending applications, especially from institutions coming in from out of state.
8. An annual hearing process should be established prior to the supervisory agencies compiling their annual reports on CRA enforcement. This should be a national forum, with resources for some travel and preparation of materials for community participation. It should focus attention both on the accomplishments in creating access to credit and expanding development banking activities and it should focus on a community review process of the effectiveness of the regulatory agencies in carrying out their enforcement responsibilities. One part of this process should be a Congressional hearing process. I think the sudden rush of concern for enforcement as a result of these hearings should be evidence of the therapeutic effect of such a process.
9. In its deliberations on housing and economic development programs, Congress should require an assessment of the ability of each program to encourage development banking and nondiscrimination. There are many ways in which public programs can leverage private credit and expand the overall impact of public funds.
10. Finally, the Federal government should take a cue from the increasing number of state and local governments that are developing plans to require that only lenders with outstanding reinvestment records can hold public deposits, receive fees and commissions, or other compensation for providing services to agencies of government. This would reward the lenders who are already doing their jobs and getting little in return, and it would provide an added incentive for other lenders to rethink their attitudes about the possibilities of investments in older, minority, and economically distressed communities. Generally, banking privileges should be linked to a lender's reinvestment record.

Under the present chairman, this has been a Committee which has always taken the lead in reinvestment policy. Mr. Chairman, I thank you for this opportunity for me to express my views on these matters. I commend you for your outstanding efforts in the past. When you leave here, you will be missed.

A TOOL FOR COMMUNITY CAPITAL:  
HOME MORTGAGE DISCLOSURE ACT  
1985 NATIONAL SURVEY

A WORKING PAPER:

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SUMMARY

The overall goal of the HMDA was to produce data which would be a resource to create dialogue between the private lenders and the community and government concerning the access to private capital markets. It was further anticipated that where needs could be identified which could be served by the private lending market, the HMDA would help in the identification of these markets, the creation of programs and policies to meet these needs, and the monitoring and evaluation of these reinvestment efforts. One common appeal by community leaders in the initial effort to create the HMDA was, "give us the lending data and we will create the programs to reinvest in our communities."

In 1985, the National Training and Information Center (NTIC) sent out a survey to assess uses of the HMDA. The Cooperative Community Development Program, at the University of Minnesota, tabulated these surveys and did follow-up phone interviews with a sample of the respondents. This survey was compared to the larger survey efforts funded by HUD and carried out by NTIC in 1977 and 1979. This report compares the results of these three surveys in order to define trends in HMDA uses and to assess the impact and problems associated with HMDA uses.

The HMDA surveys account for at least \$3.7 billion in community reinvestment related to uses of the HMDA, with the real total probably being substantially higher.

All of the uses identified in this survey indicate that the HMDA does act as a major reinvestment resource, leveraging critical private sector dollars at almost no direct expense to the government. The involvement of community people in the assessment of their own credit needs, the analysis of the performance of local lenders, and the development of policies and programs to meet these needs on a basis which is economically viable for the lenders is the best single indicator of the larger success of the HMDA as a major stimulus for private reinvestment dollars. In addition, the HMDA has become a critical tool in the regulation of financial institutions to hold them accountable to serve community needs as they also seek sound and profitable markets.

The HMDA is used by individual lenders to review their own performance. The HMDA is increasingly used by government agencies to develop programs and monitor results in the areas of housing, community economic development, and fair housing. The HMDA has been used by community groups in at least 38 states and the District of Columbia and in at least 117 different cities. The report estimates that there are over 7,500 different uses of the HMDA each year.

What is most important, however, is not something which can be expressed simply in counts of uses or users. The use of the HMDA has allowed people to become active citizens, not only in the political process but in their local economies as well. The evolutionary efforts of the late 1960s and early 1970s to develop community-based economic development

capacities have accelerated rapidly with the advent of the HMDA. The HMDA has made not only housing issues, but economic development issues a matter of citizen participation and debate. The dialogue created between the public and the lending institutions around the HMDA has drawn the lending institutions into serving community credit needs and drawn the community into public discussion about the role and resources of the private capital markets. Clearly, many of the community development and reinvestment programs created around the country by those who have never directly used the HMDA find their genesis in the dialogue created by the HMDA.

The programs created out of negotiations with lenders arising from HMDA analyses have created a plethora of "public/private partnerships". These programs appear to be on the cutting edge of efforts to work out the proper roles and tensions between the citizens, the government, and the private sector in our democratic form of government and free enterprise capitalistic form of economy. The HMDA and the CRA provide simple tools which create public access to lending data and which require the managers of government-protected pools of capital to be responsible to public needs in their control of that capital. With the aid of these tools, citizens acting within their community interests, private lenders, and often government agencies as well, weave together the threads of reinvestment which are needed to repair the torn fabric of economically depressed communities. The fabric is softened and made comfortable by the freedom which these tools allow in hand-tailoring the cloth to fit the local community needs. The fabric is strengthened and made firm by the creative tensions between the public and private sector goals.

The HMDA is used to create funds for economic development as well as housing, but it is limited by several major problems. The HMDA does not cover rural lending, the Veteran's Administration, commercial lending, or mortgage banking companies. These omissions seriously reduce the potential of the HMDA to leverage private investment to meet housing and economic development needs.

Finally, groups using the HMDA are concerned that in spite of its value and growing regular usage, it is not a permanent law.

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THURSDAY, SEPTEMBER 10, 1987

## Public Service or Blackmail? Banks Pressed to Finance Local Projects

By RICHARD B. SCHWITT

**Staff Reporter of The Wall Street Journal.**  
First Interstate Bancorp considers itself a good citizen. It recently sponsored a program to teach California schoolchildren about finance, and it bankrolled a casino operator's antique-car museum in Nevada, among other causes.

But some people aren't impressed with the bank holding company's idea of charity. "Cosmetic," says Alberto Nieto, leader of the Fresno Organizing Project. The group is threatening to hostile up a plan by First Interstate to expand into Texas, unless the company starts financing more low-cost housing for the poor and loans to minority small businesses.

The Los Angeles banking concern can't afford to ignore such demands. Increasingly, community activists are taking banks to task—and winning large financial concessions—under the federal Community Reinvestment Act.

### Stalling Mergers

The law requires that banks and thrifts prove to regulators that they "serve the convenience and needs" of local communities. By charging that banks haven't provided adequate community services, the activists can threaten to stall any merger. To avoid such delays, banks often agree to pledge millions of dollars in financing to community projects if the groups will drop their objections.

This year alone, banks are expected to pay up \$1 billion in low-cost loans and other aid for such causes as housing for the poor and the development of inner-city businesses. Wells Fargo Bank is providing low-cost financing for a shelter for battered women. First National Bank of Chicago is helping finance work on the headquarters of the National Training and Information Center, a major community-action group.

As bank mergers have increased in recent years, community groups have stepped up their protests under the Community Reinvestment Act. "Mergers have provided a forum for groups to raise grievances to get banks to spell out commitments which they wouldn't otherwise make," says Allen Flabbein, general counsel for the Center for Community Change, a Washington, D.C., group that organizes community protests.

Most bankers take a dimmer view of the process. They say the activists are stretching the intent of the law, which they criticize as vague. Some bankers say they are being forced to take on duties that government agencies should provide. Others contend that they have capitulated to demands that amount to extortion—just to avoid delaying a proposed merger.

"Banks see it as a payoff" to prevent the postponement of mergers, says Robert E. Hannan, a Washington banking lawyer and a former Federal Reserve Board official. "Pure blackmail" is how

Edward E. Crutchfield Jr., First Union Corp. chairman and chief executive officer, described the process at a banking conference last fall.

But regulators say the activists play an important role in seeing that community-service requirements are met. Jim Lowell, community-affairs manager for the Federal Reserve, says the activists are helpful in assessing how well banks are meeting their obligations. Moreover, he says, the filings have rarely delayed mergers.

About \$5 billion in concessions have been won since Congress enacted the law nine years ago, including \$1 billion last year, activists and academic groups estimate. Since 1984, when the surge in bank mergers began, there has been an estimated fivefold increase in the number of mergers that community groups have formally protested.

Mr. Nieto, head of the community group that has taken on First Interstate, says federal data show that the bank has made

**ONE BANK has balked at setting aside money for low-income loans at preferential rates. 'We are a bank,' says an official. 'We can't give away money.'**

few recent mortgage loans in West Fresno, a low-income and predominantly black and Hispanic area. Among other demands, his group wants the bank to pledge \$28 million in favored-rate residential and commercial loans over three years for borrowers in West Fresno.

So far, First Interstate, which denies Mr. Nieto's charges, has offered to increase its marketing in West Fresno and has promised to give special consideration to any loan requests from there. But it has balked at setting aside a specific amount for low-income loans, especially at preferential rates. "We are a bank," says Jerry Lowner, a First Interstate lawyer. "We can't give away money."

Other banks virtually have done that in the concessions they granted. Three banks in Chicago agreed to waive closing fees or other loan costs on a \$153 million project to rebuild old homes and finance small businesses in several Chicago neighborhoods. The project settles several merger challenges filed by community groups. Charlotte, N.C.-based First Union agreed to give cash rebates totaling 5% of annual loan payments to certain low-income customers who pay home-improvement loans on time.

This year, First National Bank of Chicago will make more than \$500,000 in grants for community activities, for in-

stance—more than double the amount given before its settlement. The aid includes seed grants for fledgling inner-city businesses, including a telephone-answer company, a contract-sewing business and an apartment-maintenance firm. The bank is also giving \$20,000 to help the National Training and Information Center, a leading organizer of Community Reinvestment Act protests, rehabilitate an abandoned Chicago beauty school as its main office.

As part of its \$1.1 billion acquisition of Crocker National Bank last year, Wells Fargo Bank promised to provide \$41 million in low-cost financing for community projects. Wells Fargo won't comment on terms, but sources say the bank has provided low-cost financing for ventures including low-income apartments in the San Francisco Mission district and the shelter for battered women.

### Interpreting the Law

Banks often voice support for such projects and some—including Wells Fargo—say they would have provided much of the aid anyway to fulfill their obligations under the Community Reinvestment Act.

But many banks say the concessions they are being pressured to make go beyond the act's intended requirements. The law was passed at a time of congressional concern over "redlining," in which banks refuse to make loans in certain areas—mainly poor or minority neighborhoods. "It is an act that encourages outreach" to all communities, says Maroon Cowell, First Union general counsel. "It is not an act that requires bad loans or contributions."

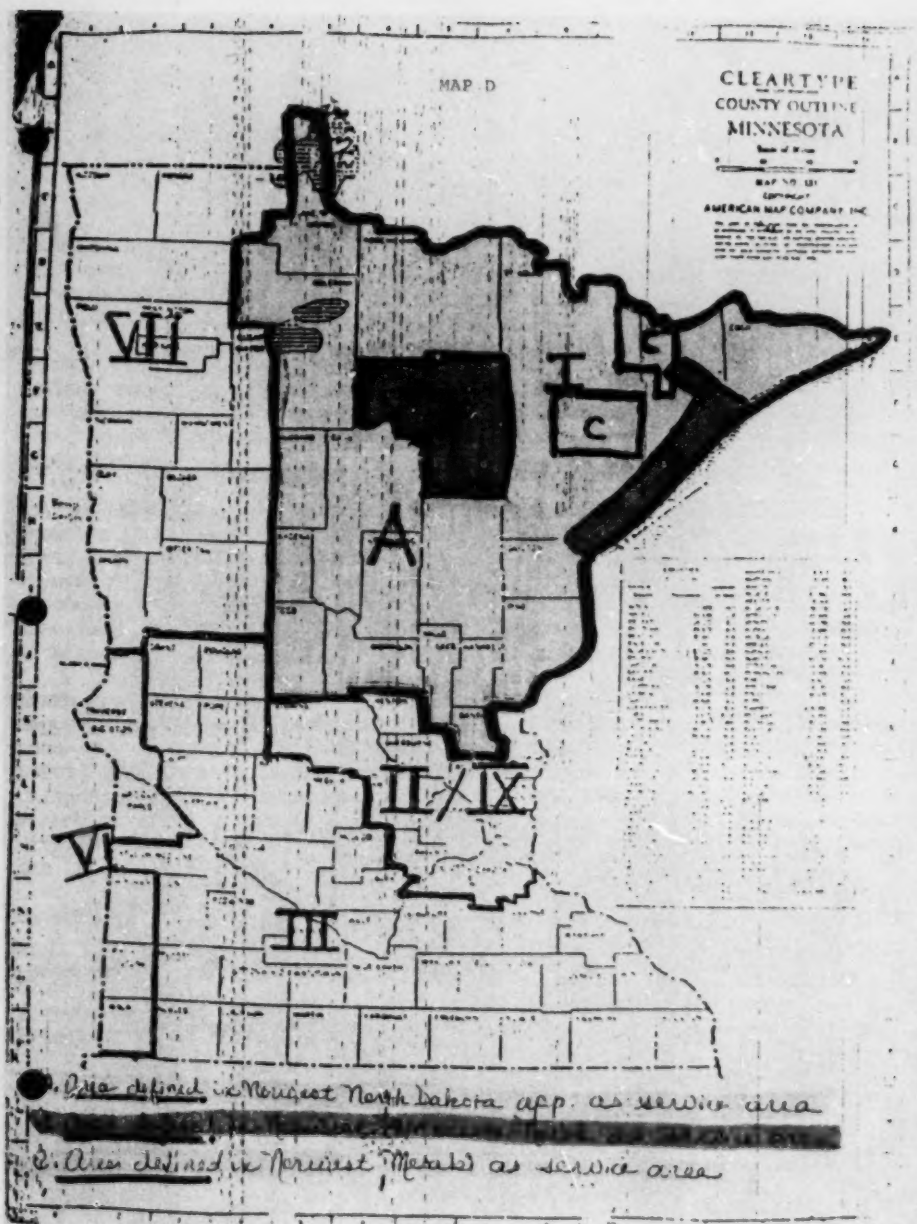
Regulators conduct periodic reviews to see that Community Reinvestment requirements are being met. Mr. Cowell and other bank lawyers say banks receiving passing grades shouldn't face merger delays if community groups suddenly object.

But activists say that regulators—swamped by bank failures and other financial problems—can give only cursory attention to community concerns.

Some banks have begun to balk at the groups' demands. New Orleans-based Hibernia Bank, for instance, refused to negotiate with the Association of Community Organizations for Reform Now, or ACORN, which objected to Hibernia's acquiring another Louisiana bank last year. Hibernia won Fed approval, but after a nine-month delay, and subject to several conditions—including an unusual arrangement in which the bank will report to the Fed about its community activities.

Other banks have become more enthusiastic. Richard Hartsock, a senior vice president for Chicago's First National, thinks neighborhood lending is good business, noting that none of the bank's recent community-development loans has gone bad. But he adds, "I may be the last bleeding-heart liberal in the banking industry."

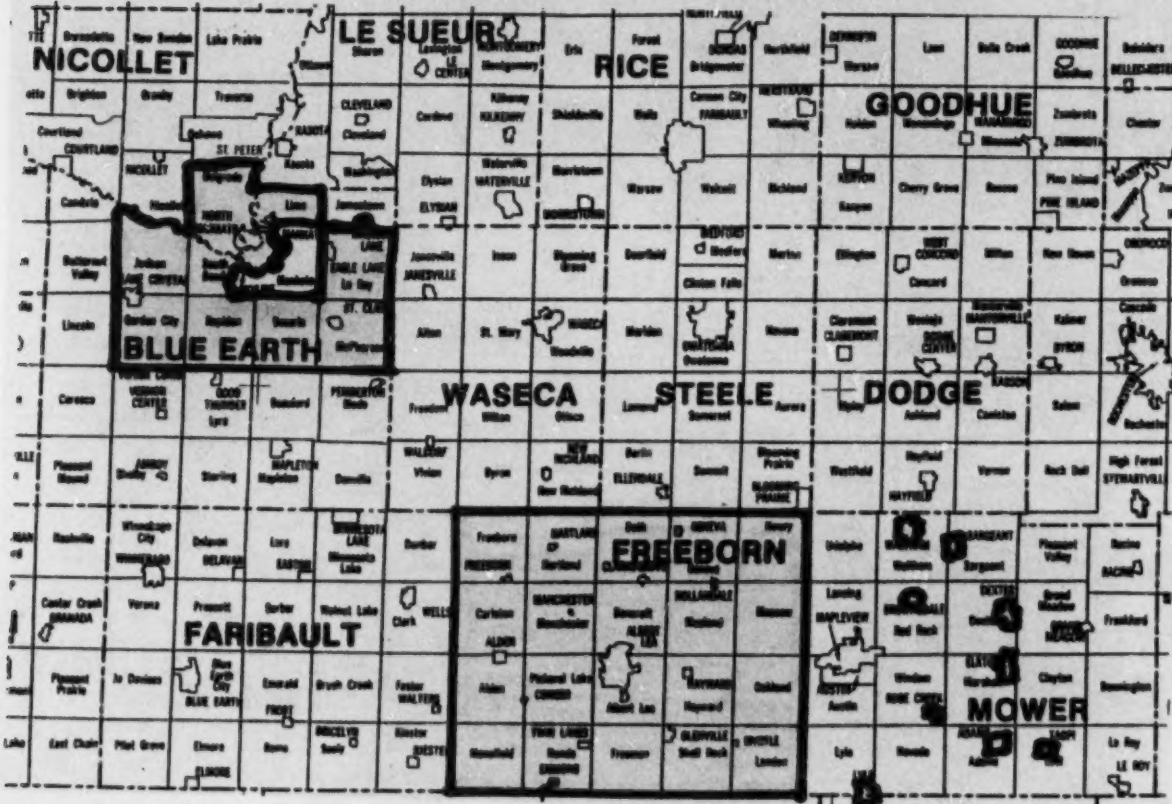




Attachment # 3



MAP B: SERVICE AREA OF PROPOSED NORWEST BANK SOUTH CENTRAL, N.A. ACCORDING TO THE VERBAL



The map displays the following counties and their locations:

- Le Sueur:** Located in the north-central part of the state, south of the Canadian border.
- Rice:** Located to the east of Le Sueur.
- Goodhue:** Located to the east of Rice.
- Steele:** Located south of Rice and Goodhue.
- Dodge:** Located to the east of Steele.
- Mower:** Located in the south-central part of the state, south of Dodge.
- Faribault:** Located in the south-central part of the state, south of Steele and Dodge.
- Blue Earth:** Located in the west-central part of the state, south of Le Sueur.

Other visible counties include: Nicollet, Winona, Lenoir, Jackson, Lincoln, Douglas, and others. Major cities like Minneapolis, St. Paul, and Duluth are also marked.

The CHAIRMAN. Thank you, Mr. Bradford, very much. You gave us excellent questions for the regulators when they appear before us tomorrow.

Miss Revere, go right ahead.

**STATEMENT OF ELSPETH REVERE, PRESIDENT, WOODSTOCK INSTITUTE, CHICAGO, IL**

Miss REVERE. Thank you for inviting me to come this morning. My name is Elspeth Revere. I am president of the Woodstock Institute, which is a not-for-profit organization located in Chicago. The Institute works both nationally and locally, in both a research and a technical assistance capacity, helping to bring the resources of financial institutions into low income communities.

I'd like to briefly discuss with you three points this morning and to talk primarily about some studies that we have just completed on redlining and disinvestment.

**REDLINING AND DISINVESTMENT**

The first point I'd like to make is that disinvestment is still a problem in low income communities. The second is that regulatory enforcement of the CRA is inconsistent, at best, and, the third is that there seems to be an emerging consensus at least on some of the ways to strengthen the effectiveness of the CRA.

First, I'd like to briefly describe our research and I'd like, if I could, to put some of the reports of these studies in the record but not to talk with you in great detail about them this morning.

The CHAIRMAN. Fine. We'd be happy to accept them.

Miss REVERE. Thank you. The Woodstock Institute has conducted lending studies of the Washington, DC, Denver, and Chicago metropolitan areas. In each case, we looked at the lending of every financial institution that reported under the Home Mortgage Disclosure Act. I'd like to join with other people who have spoken with you this morning in thanking you for your efforts to permanently pass the HMDA. It's been an extremely valuable tool for us.

In our studies in Washington and Chicago and in Denver, we were shocked to find the extent to which racial discrimination does remain a problem in each city. In particular, right here in the District of Columbia, race was the strongest predictor of any factor we looked at in influencing lending. This means that a higher income black neighborhood received less lending than a lower income white neighborhood, everything else being equal.

This pattern of racial discrimination was repeated in Chicago and even in Denver, a city with a much smaller concentration of minorities.

Second, we found that the older central cities received much less lending than the surrounding suburbs, even when you take into account higher housing prices and continuing new development in the suburbs.

Third, and probably most surprisingly, we found that normal market factors, like the amount of home ownership, single family housing, and even levels of income, did account for the amount of lending in suburbs but not in the central cities. This suggested to us that financial institutions are overlooking or in some other way



failing to serve on the central city markets even when there are good customers with money to pay back the loans.

A fourth point I'd like to mention comes from a briefer study we did of commercial lending data in Chicago. As was mentioned earlier, there is not a national data base of commercial lending data, but there is an increasing concern in communities around the country that there needs to be money for loans for small businesses in particular because that's the sector in which jobs are created, and what our communities need most, of course, is jobs.

We found in our examination of the Chicago data that some of those same patterns we saw in housing also held true in business lending, that the lending was much greater in the suburbs and that in the city it was not spread throughout the neighborhoods where it is needed. We very much think that this requires a closer look with a lot more data, and I'll get to that in a minute with my recommendations.

Our experience has shown us that there are two explanations for why disinvestment persists, even with such excellent legislation as the CRA.

First, enforcement of the CRA has been largely left to community organizations and they only have an opportunity to enter into the process when there's an application before the regulators. While this has resulted in billions of dollars in specific loan agreements between particular banks and particular communities around the country, there has not been a regulatory process that ensures that every regulated financial institution contributes to community reinvestment as required under the CRA.

In fact, it would be very hard to see how the actions of the regulators have resulted in any dollars at all going to meet reinvestment needs in low income communities.

Second, the process of enforcement has been very inconsistent and sometimes sloppy. While I would commend the staff of the Federal Reserve Bank of Chicago for its effort to help communities and banks forge agreements, other regulators in our experience have not been as knowledgeable or as effective.

In particular, we had a recent experience with the FDIC in Chicago. We were assisting a community group in a negotiation with a bank and the FDIC was the regulator. We requested that the CRA examiner's summary assessment of the CRA examination be provided to us. Under the Code of Federal Regulations, that's supposed to be in the public applications file.

We were told by the FDIC that there was a written internal policy that contradicted the published regulations that said if the bank had a "one" or a "two" rating, then the examiner didn't have to prepare a summary assessment. Therefore, the summary assessment was not available in this case because the bank had received a "one" or a "two."

We then went and asked for summary assessments for all 19 of the banks that currently had applications before the FDIC in Chicago and were told that none of those were available either because they all had "one" or "two" ratings.

This suggested to us that, first of all, high ratings are the norm in CRA examinations. We had always thought this, but this was the first piece of evidence that we had about this problem.

Second, that regulators differ enormously by regulatory agency and also by part of the country in the level of energy and competence with which they implement the CRA.

I'd like to quickly mention the obvious recommendations that come out of both our studies and our experience.

#### RECOMMENDATIONS

First, the CRA ratings need to be public and awarded competitively to ensure accountability and to begin to move towards a system where the regulators will be responsible for ensuring that each bank contributes its fair share towards reinvestment.

Second, community input needs to be facilitated through (1) a better system of notifying interested parties of relevant applications (each regulator in each part of the country has a different system); (2) a longer period of public comment in most cases, (again that varies by regulator); and (3) a process for holding on-the-record public hearings when the community requests one.

Third, disclosure recommendations for business lending are absolutely essential because there are two types of lending that the CRA covers but only one that we have information on. We do not have information on a geographic basis on where business loans are going and we need that information. The regulators need that information. And I would hope that Congress would see fit to ask for that information.

We also need that information for rural areas. We have lots of anecdotal reports on disinvestment in rural areas and yet HMDA only covers banks and savings and loans located in metropolitan areas.

Finally, we would hope that you would consider holding all companies that conduct lending accountable to CRA and that includes mortgage bankers and finance companies, as well as banks and savings and loans, and we would also recommend tying new powers for banks and savings and loans associations to excellent CRA performance.

Thank you.

[The complete prepared statement of Elspeth Revere follows:]

# CRA LOAN TABLE

## NORWEST BANK AUSTIN

Consumer Loans  
Household Items  
Automobiles  
Recreational vehicles  
and equipment  
Medical  
Dental  
Ready Reserve  
House rehabilitation  
Home improvements  
Energy conservation  
Student Loans

### Residential Loans

FHA  
VA  
Conventional  
Conventional Insured

### Community Development Loans

Commercial Loans  
Small business loans  
Farm loans  
SBA guaranteed loans  
FmHA guaranteed loans

## NORWEST BANK ALBERT LEA

Home Purchase Loans  
Commercial Loans  
Agricultural Loans  
Small Business Loans  
SBA and FmHA Loans  
Community Development Loans  
And the following consumer  
loans:  
Household items, appliances,  
furniture, furnishings,  
automobiles, recreational  
vehicles and equipment,  
mobile homes

## NORWEST BANK MANKATO

Mobile Home Loans  
Home Purchase Loans  
Home Improvement Loans  
Home Equity Loans  
Motor Vehicle Loans  
Equipment Loans  
Household Loans  
Energy Conservation Loans  
Agricultural Loans  
Business Loans  
Consumer Loans  
Overdraft Protection  
SBA Guaranteed Loans  
FmHA Guaranteed Loans  
Retail Installment Loans  
Community Development Loans  
Housing Rehabilitation Loans  
Credit Card Loans  
Open End Consumer Lines  
of Credit

## CREDIT SERVICES OFFERED BY NORWEST BANK MINNESOTA SOUTH CENTRAL,

### NATIONAL ASSOCIATION

#### I. Consumer Credit-Real Estate

- A. The Bank provides loans for home improvement, rehabilitation, and energy conservation.
- B. The Bank also provides loans for residential real estate purchase, including FHA, VA, and conventional loans on owner-occupied single-family homes and various condominium and townhouse projects. Also, swing loans are provided for purchase of primary dwelling and first mortgage single-family residential purchases. In addition, the Bank participates in the Home Mortgage Loan Program sponsored by the Minnesota State Housing Finance Agency.

#### II. Consumer Installment Loans

The Bank offers both secured and unsecured loans for such purposes as automobiles, boats, household appliances, furniture and furnishings, recreational vehicles, medical and dental expenses, income tax, vacation expenses, college tuition, and investments. Two types of installment loans are available: 1) fixed-rate and fixed-payment schedule installment loans; and 2) variable-rate with fixed monthly payments. The Bank participates in a credit card program sponsored by its holding company and offered through one of its affiliate banks. Revolving consumer credit is also available through the Bank's Ready Reserve, Home Equity Access Line, and Preferred Line of Credit.

#### III. Construction Financing

Loans are made for the construction of commercial, industrial, multi-family, and other income-producing facilities. The Bank generally requires a commitment for permanent financing from another responsible lending institution.

#### IV. Commercial Financing

Commercial financing of short-, intermediate-, and long-term nature is provided by the Bank for a variety of development, including loans granted for working capital, acquisition of fixed assets, construction of buildings, and for community development, including churches, schools, and hospitals.

## MAJOR LOAN PRODUCTS ELIMINATED UNDER CONSOLIDATION SCHEME

\*Farm loans  
\*SBA guaranteed loans  
\*FmHA guaranteed loans

\*Agricultural Loans  
\*SBA Loans  
\*FmHA Loans  
\*Consumer loans for  
mobile homes

\*Agricultural Loans  
\*SBA Guaranteed Loans  
\*FmHA Guaranteed Loans  
\*Mobile Home Loans

TESTIMONY BY

ELSPETH REVERE  
PRESIDENT

WOODSTOCK INSTITUTE  
CHICAGO, ILLINOIS

on

THE COMMUNITY REINVESTMENT ACT

Before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
UNITED STATES SENATE

10:00 a.m.

March 22, 1988

Good morning Mr. Chairman and members of the Committee. My name is Elspeth Revere. I am the President of the Woodstock Institute. Thank you for inviting me to appear before you today to present the Woodstock Institute's views about neighborhood disinvestment and the implementation of the Community Reinvestment Act.

The Woodstock Institute is a not-for-profit organization which is based in Chicago and works nationally to bridge the gap between the needs of distressed urban and rural communities and the resources of financial institutions. During the last fifteen years, the Institute has conducted extensive studies of housing credit flows and has documented continuing patterns of disinvestment in poor, working class and minority communities; it has monitored CRA performance of financial institutions and the performance of the banking regulatory agencies in enforcing the CRA; and it has provided technical assistance to community-based organizations in assessing their credit needs and in designing and implementing financing programs for affordable housing and job creation. This has included extensive research and strategic support to organizations conducting CRA negotiations.

Since passage of the Community Reinvestment Act, the Institute has used the CRA as a tool for encouraging financial institutions to increase their investment in low income and minority communities. The CRA has been and continues to be highly useful to community-based organizations in establishing partnerships with local financial institutions. However, in spite of viable and effective local partnerships, the CRA's impact has been limited by inconsistent and often ineffective enforcement by bank regulatory agencies, and this has resulted in continuing patterns of

disinvestment in urban and rural communities throughout the nation. I am pleased that the Senate Banking Committee is conducting hearings on the Community Reinvestment Act at this time, because the experience in using the CRA over the last ten years has proven that it is an important law, and that there are ways in which its implementation can be strengthened.

I would like to address my remarks this morning to four topics:

1) the continued problems of disinvestment in working class and poor communities as has been documented by recent Woodstock Institute studies; 2) the ways in which the Community Reinvestment Act has, and continues to be an effective tool in addressing reinvestment needs; 3) the ways in which the effectiveness of the Community Reinvestment Act has been diminished by the enforcement practices of the regulatory agencies; and 4) measures that the Woodstock Institute recommends to increase the effectiveness of the CRA.

I. Disinvestment remains a problem in many urban and rural communities throughout the nation. Loans for the purchase, construction, and rehabilitation of homes and apartment buildings, and the creation, expansion and operation of businesses are essential to the vitality of neighborhoods and in turn to the health of the economy of cities and regions. The importance of such lending was recognized by Congress when it passed the Home Mortgage Disclosure Act in 1975 and the Community Reinvestment Act in 1977.

To evaluate the status of such lending, the Woodstock Institute has recently completed housing lending studies in the Washington, D.C., Chicago and Denver metropolitan areas. Each of these studies examined all of the housing loans reported by every bank, savings and loan association and large credit union as required by the Home Mortgage Disclosure Act over a period of at least two years. In addition, the Institute recently

completed a study of commercial lending in Chicago, using two years of commercial lending disclosure data required of those financial institutions bidding for city deposits.

Our studies included data from 106 financial institutions in Washington, 148 financial institutions in Denver, and 481 financial institutions in Chicago. In each of these cities, a substantial amount of housing and commercial loan dollars were reported during the periods we studied. However, the patterns of lending within each of the metropolitan areas was a matter of grave concern. Among the findings of the studies were the following:

A. Racial discrimination remains a problem in the flows of housing loans. Perhaps the most troubling of our findings is that patterns of racial discrimination in lending remain evident. In all three cities studied, minority communities received less lending than white communities with similar characteristics such as income levels and numbers of single family homes. In Washington, D.C., the most statistically important predictor of lending in the central city was race. This was statistically stronger than the ability to pay (income) or any housing characteristics. In other words, areas within the District of Columbia with higher income black populations received less housing lending than those areas with lower income white populations, all else being equal.

This pattern was also evident in Chicago. Of Chicago's 77 community areas, 33 have predominantly black or hispanic populations, and every one of these minority communities fell below the citywide lending average, receiving less than \$2,000 per housing unit over a four year period. Finally, in Denver, which does not have the concentrations of either poverty or minorities found in older urban areas, a direct and inverse



relationship was found between the percentage of blacks within a community and the amount of residential lending that the area received.

B. Older central cities received far less lending than the surrounding suburbs. A second troubling finding of these studies is that the suburban areas received far greater amounts of housing loans than did the older central cities. While some of this would be expected due to investments in new development that are still occurring in some suburbs, the large disparities result in neighborhoods of working people which are receiving very little lending. In Chicago, the suburbs received an average of over \$5,000 per housing unit compared to the city's \$2,000. This was a difference that cannot be entirely explained by differences in housing prices or amounts of new construction. As a result of this credit disparity, many white, ethnic and integrated neighborhoods joined black and Hispanic communities in suffering from effects of disinvestment.

C. Market factors were less clearly associated with lending levels in the central cities than in the suburbs. Surprisingly, factors such as housing age, rate of homeownership, and income were stronger predictors of the amounts of housing lending in the suburbs than in the cities. In Washington, median family income was a strong predictor of lending in the suburbs, but was not a factor in the central city. Homeownership rates predicted lending in both city and suburbs, but much more strongly in the suburbs. By contrast, racial makeup, which is not a market factor was a predictor of lending in the city but not in the suburbs. This suggests that lenders are not responding to market opportunities in the central cities in the same way they do in the suburbs.

D. Very little lending is flowing to apartment buildings, the source of much affordable rental housing in urban areas. In each city studied, the amount of lending directed towards the purchase, construction

or rehabilitation of multifamily buildings was extremely small. In Denver, only \$784 was lent per apartment over a two year period, in Chicago only \$450 per unit was loaned over four years, and in Washington, 97% of the metropolitan area census tracts received no multifamily loans at all. This means that the most affordable type of urban housing is receiving almost no investment in maintenance or rehabilitation, and few new modestly priced units are being built.

E. Commercial disinvestment is a growing concern. Not only are old patterns of racial discrimination and central city disinvestment in housing still with us, there is a growing concern about commercial disinvestment, particularly loans to small businesses. The community organizations that first identified patterns of residential redlining have increasingly become concerned about job retention and creation in their communities. Because small businesses have been identified as the sector in which the most new jobs are created, there is a growing concern that loans be available to support small business startups and expansion in distressed communities. In addition the older small manufacturers, distributors and other businesses that form the backbone of employment need credit to reinvest in new equipment, refurbish old buildings and expand to meet new opportunities. Many local economic development efforts have arisen to address this need, and private financing is a crucial component to making these economic development efforts successful.

Because there is no commercial lending data source similar to FHIA, it is difficult to assess commercial credit needs. A local ordinance in Chicago requires all banks requesting city deposits to provide annual information on their commercial lending. Of the twenty-six banks (representing 80% of commercial bank assets) reporting such data over the most recent two-year period, a recent Woodstock Institute study found that

90% of all commercial lending was concentrated in either the suburbs or Chicago's downtown, and only the remaining 10% was lent in the rest of Chicago's neighborhoods. Clearly, commercial disinvestment is a reality that must be addressed.

F. Regulated financial institutions are leaving low income and minority neighborhoods. Our monitoring of bank applications and mortgage bankers, and our research on the banking activities of nonfinancial corporations, points out another disturbing trend. As banks and savings and loans are closing their branches or entirely leaving low income communities, the community loses a source of banking services. In many communities this gap is filled by currency exchanges, finance companies, and mortgage bankers, which can be extremely expensive alternatives to the service provided by regulated institutions.

II. The Community Reinvestment Act has had a strong and positive impact on community reinvestment needs. Despite continuing problems with disinvestment in many urban and rural communities, the CRA has been extremely important to local organizations in developing partnerships with financial institutions. Community organizations in low income areas have become adept at monitoring financial institution activities that would trigger an opportunity for a CRA protest or challenge, and using that opportunity to negotiate with the institution to help meet local credit and banking service needs. Through these processes, local organizations have taken the time to assess their own credit needs, evaluate the bank's performance and the potential impact of the proposed action, and participate in discussions with bank officers on local credit needs and ways in which bank products and services could be directed so as to meet them better.

This process has resulted in billions of dollars in loan funds for low and moderate income communities throughout the country, and in new working partnerships between local communities and financial institutions. In Chicago alone, agreements with four large commercial banks created loan pools of almost \$200 million, and CRA agreements with local neighborhood banks have added up to \$20 million in loan pools for a specific neighborhood.

In spite of these success stories, however, the CRA has so far failed to realize its potential to solve disinvestment problems. This is because CRA agreements have been forged with a limited number of financial institutions in specific communities throughout the country. The heavy reliance on community organizations to monitor CRA compliance means that those financial institutions applying to change their charters, and especially those located in areas with sophisticated community organizations, are subjected to the greatest scrutiny. Meanwhile, financial institutions with similar reinvestment deficiencies go unnoticed because they do not apply for permission for changes subject to CRA.

Because of the large numbers of mergers and acquisitions in the past several years, many opportunities for CRA negotiations have arisen. As the pace of such changes inevitably slows down in future years, the need for rigorous CRA enforcement by the banking regulators will become even greater.

III. The CRA has not been rigorously enforced by banking regulatory agencies. Unlike the many CRA agreements that have been forged with particular banks, the enforcement activities of the banking regulators has done little to bring reinvestment to needy communities. The enforcement of the CRA by banking regulatory agencies has been inconsistent and often disinterested. Regulations and procedures sometimes serve to lessen rather

then increase the impact of the law. Perhaps most obvious is the inconsistency of enforcement. While each of the regulatory agencies, the Federal Reserve, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Home Loan Bank has responsibility for CRA enforcement in some circumstances, the rigor with which this responsibility is carried out varies substantially by agency, by region, and by size of financial institution. For example in Chicago, the Federal Reserve Bank takes an active role in assisting banks and community groups in coming to agreement on reinvestment programs. By contrast, the FDIC in Chicago has shown little interest or expertise in fostering reinvestment agreements. In a recent negotiation with a local Chicago bank, for example, the Woodstock Institute and the Legal Assistance Foundation of Chicago discovered that the FDIC's regulations required that the summary assessment of the last CRA examination be made available in the application file for public inspection. However, in apparent contradiction to these regulations, an internal FDIC policy stated that an assessment need not be prepared when an applicant receives a "1" or a "2" CRA rating from the examiner. The effect of this contradictory internal policy was a serious lack of information in the public information file.

A second area of inconsistency is in the strictness with which different financial institutions are examined for CRA compliance. Whereas some financial institutions may be audited for CRA compliance annually, others may not be examined for community reinvestment compliance for several years. Ironically, some of the financial institutions with well-publicized neighborhood lending programs receive the most rigorous CRA examinations.

The CRA enforcement activities that are undertaken by banking regulatory agencies are conducted largely outside of public scrutiny.

Therefore, it is difficult to identify the strengths and weaknesses of the process. Of greatest concern to those working to relieve disinvestment problems is that the evaluations of CRA performance by financial institutions, the so-called "CRA ratings" are neither publicly available nor comparative in nature. In the FDIC case mentioned previously, the summary assessment was requested for all nineteen applications then pending before the Chicago FDIC office. In response, the Woodstock Institute was told that no summary assessments were available because all of the financial institutions in question received better than a "3" rating. The Institute's experience in evaluating bank CRA performance indicates that it is highly unlikely that all nineteen institutions were making substantial contributions to community reinvestment.

The lack of public availability of ratings allows the process of evaluation to go unobserved and unchallenged by those in the best position to do so—the community organizations. The lack of comparison in the ratings has resulted in what is, by all reports, a "pass-fail" system where every financial institution receives a high CRA rating and, in effect, passes. This has meant that no bank applications have been denied on CRA grounds in recent years, and very few have had reinvestment conditions attached to their approval. It has also meant that there is no recognition of the fine record of those financial institutions that have made a serious effort to fulfill their CRA responsibilities—they are "passed" along with everyone else.

In addition, the regulatory agencies have failed to account to either Congress or the public as to the nature and extent of disinvestment problems or the impact of reinvestment activity by the financial institutions on these problems. This is particularly true in the area of commercial lending analysis, where publicly available data is only

available in a handful of cities and states. The Woodstock Institute studies that I mentioned earlier are examples of a type of analysis that would assist the regulators in assessing CRA compliance and the impact of bank reinvestment activities. This information is important to Congress in monitoring the effectiveness of the CRA, and to the public to whom affordable housing and job creation is important. Yet the burden for monitoring such activity again falls on the nonprofit sector which is least able to afford it.

Finally, the banking regulatory agencies have weakened the community's role in enforcement of the CRA through their regulations and procedures. They have shortened the comment period during which community organizations have the opportunity to conduct research on the bank's lending performance and evaluate the impact of the proposed charter change so that the comment period allowed by the Federal Home Loan Bank Board is only 10 days, for the FDIC is 15 days, and for the Federal Reserve and the OCC is still only 30 days. In addition, the applications bulletin voluntarily prepared by each regulator describing applications received (and therefore CRA opportunities) is sent out after the applications have been approved by the FHLB and often late by the OCC. In addition, federal regulators, often the only link between the financial institution and the community organization, do not all encourage discussions between the two to settle their differences to the extent that the Federal Reserve Bank of Chicago does, nor do they work to ensure that the two sides negotiate differences from equal footings.

#### IV. Recommendations

In order to more fully realize the potential of the Community Reinvestment Act in alleviating problems of disinvestment in distressed communities, the Woodstock Institute recommends the following changes in

regulatory procedures, disclosure requirements, and tying new powers to reinvestment responsibilities:

A. Regulatory procedures. Several changes should be made in regulatory procedures to enable: 1) greater and more effective participation by community organizations in the oversight process, 2) consistency of CRA evaluations throughout the regulatory system and the country, 3) accountability of the regulatory system to Congress and the public, and 4) use of the regulatory system to promote reinvestment by every bank and savings and loan association in the country. Many of these changes are contained in HR 4022 and HR 4026 and are currently under discussion in the House of Representatives.

(1) Require the regulators to publicly disclose CRA ratings. Public disclosure of CRA ratings and assessments will enable Congress and citizens to monitor the enforcement of the CRA, and to identify particular problems with local banks.

(2) Require the regulators to develop a CRA rating system that is comparative. This will more fairly acknowledge the contributions of those financial institutions with active reinvestment programs.

(3) Require the regulators to provide timely notice of pending applications to all interested parties to encourage public comment.

(4) Allow a longer period for public comment on applications.

(5) Require that all regulators conduct a public hearing on an application when the request is made in a timely manner.

B. Disclosure Requirements. While the Community Reinvestment Act now requires financial institutions to help meet the credit needs of their local communities, there is little opportunity to assess the credit needs or bank performance in meeting those needs in the areas of commercial or industrial lending. In addition, little information is available for those

communities which do not fall within a metropolitan statistical area.

(1) Adopt legislation that requires financial institutions to annually report the location, size and type of their commercial and industrial loans. This will provide regulators with the information necessary to fully enforce the CRA, and allow local community organizations and public officials to assess unmet credit needs and evaluate the performance of particular financial institutions. This data should be collected and compiled through a central source, and made available to the public on computer tape in a similar manner to the way that HMDA data is collected and disseminated.

(2) Direct a regulatory agency to establish a review board to analyze the data and to make the results available to local organizations. Such a review board is included in the Kennedy bill (HR 4022) being considered by the House.

(3) Expand the Home Mortgage Disclosure Act to include reporting of data for rural areas. At present, little information is available to document the disinvestment problems in rural communities.

C. Community Reinvestment and New Powers and Institutions. At the present time, banks are seeking to expand their activities into new fields. Conversely, there are many lenders which are not subjected to banking laws and regulations:

(1) Allow new powers only to those banking institutions with comparatively high CRA ratings. A competitive system of awarding high CRA ratings will limit the percentage of banks receiving "1" or "2" ratings. These institutions with superior CRA performance should be rewarded with new privileges to take on the new powers that they seek.

(2) Require institutions which are not subject to CRA but are conducting large amounts of lending to observe both reinvestment and

disclosure provisions. These are primarily finance companies and mortgage banking firms which are subsidiaries of nonfinancial corporations and insurance companies. Mortgage bankers are currently doing an increasing volume of conventional, single family mortgage lending throughout the country, yet only those which are subsidiaries of bank or savings and loan holding companies are subject to either CRA or HMDA. These corporations must be subjected to the same requirements as banks and savings and loan associations. Finance companies, no longer just lenders of last resort, now make a significant portion of the commercial loans. Estimates indicate that at least 15% of all commercial loans are made by finance companies, yet they are not subject to CRA.

In conclusion, I would like to reiterate that the Community Reinvestment Act has been an extremely valuable tool to community organizations and community development efforts. Yet disinvestment problems still remain, largely because while every financial institution in the country is subject to the law, many are not contributing to reinvestment efforts. The Community Reinvestment Act will only realize its full potential when it is fairly and consistently enforced by all of the regulators, when it is equally applied to all who extend credit, and when sufficient public information is available to adequately monitor both local credit needs and the performance of financial institutions in meeting those needs.

Thank you for the opportunity to speak with you this morning. I would be happy to answer any questions.



PARTNERS IN NEED:  
A FOUR-YEAR ANALYSIS OF RESIDENTIAL  
LENDING IN CHICAGO AND ITS SUBURBS

AUGUST, 1986

BY  
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EXECUTIVE SUMMARY

Loans for new housing construction, purchasing and remodeling homes, and acquiring and rehabilitating apartment buildings are essential to the vitality of neighborhoods and in turn to the health of the economy of cities and regions. Between 1980 and 1983, regulated financial institutions made a total of \$10.4 billion in residential loans in the Chicago metropolitan area. This report, "Partners in Need," presents the findings of Woodstock Institute's comprehensive study of the distribution of these loans which were made by over 500 banks and savings and loan associations in the Chicago metropolitan area between 1980 and 1983.

This report documents huge inequalities in the distribution of housing credit throughout the Chicago area that cannot be explained solely by market factors or differences in selling prices. While many communities and suburbs received thousands of loans and millions of dollars, others received little and some received virtually nothing. In particular, this report describes the many working class and middle-income, white, black and Hispanic neighborhoods in Chicago which are "Partners in Need," receiving inadequate housing credit for their neighborhoods to thrive, or sometimes even to survive.

Major findings of this report are that, during the years 1980-1983:

- The suburbs received more loans of every type and more loan dollars than did the city — an average of \$5,345 per housing unit compared to the city's \$2,179 per housing unit, a difference that cannot be entirely explained by differences in price.
- Among Chicago's neighborhoods, lending differences were extreme. They ranged from a low of \$113 per unit in Washington Park to a high of \$11,431 in the Loop.
- Only four of Chicago's neighborhoods received as much or more residential credit as the average suburb. These Community Areas are the Loop, O'Hare, Lincoln Park and the Near North Side.
- Every single one of the thirty-three black and Hispanic communities in Chicago fell within the two lowest categories of lending.
- A substantial number of white, Hispanic, and integrated communities with varying income levels such as Bridgeport, South Lawndale (Little Village) and Lincoln Square joined the black communities in the "Low Credit" category, and are "Partners in Need" of residential credit.
- Factors and characteristics which can be considered indicators of demand, including single-family housing, owner occupancy, turnover and income, do not explain the large differences in level of lending in Chicago neighborhoods.

\* Multifamily buildings in Chicago received a total of only \$224 million in loans, a mere \$450 per housing unit. They were effectively locked out of the credit market.

The report recommends that community organizations, financial institutions, government officials and policymakers all work to increase the flow of credit to those neighborhoods and communities in need. It identifies opportunities for community organizations to forge partnerships with lenders; financial institutions to develop programs and marketing efforts that ensure that all creditworthy borrowers have access to the credit they need; local and state officials to link government deposits to reinvestment performance and to creation of special lending initiatives; regulators to actively enforce the Community Reinvestment Act; and Congress to permanently extend the Home Mortgage Disclosure Act.

VISTA OF OPPORTUNITY:

AN ANALYSIS OF 1983 AND 1984

RESIDENTIAL LENDING IN THE

DENVER/BOULDER SMSA

FEBRUARY, 1987

BY

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## SUMMARY REPORT

### INTRODUCTION

Credit to purchase and sell homes, to finance repairs and improvements, to start small businesses and to rehabilitate older apartment buildings can make the difference between the life or death of a neighborhood's economy, the economy of a city or that of a whole metropolitan region. When loans are made in an area, the results are visible--needed repairs are made to homes, there are few vacant buildings, and commercial areas are lively and well-used. By contrast, an area being denied credit exhibits the signs of lack of hope and confidence in the future. Buildings are boarded up, homes are not maintained, and stores show out-dated merchandise and few customers.

While all types of loan activity are needed to make economies work, housing loans are regularly documented by banks and savings and loan associations. Through the mandate of the Home Mortgage Disclosure Act of 1975 (HMDA), all regulated banks and savings and loan associations must report the number and dollar amount of their residential loans. These data show the number and amount of single family mortgages, home improvement loans, multifamily (apartment building) loans and loans made under the Federal Housing Administration and Veterans Administration mortgage programs for each census tract.

Until recently there was no efficient way to use this data to monitor the flow of housing credit throughout large metropolitan regions or to diagnose problem areas in time to apply remedies to increase the availability of credit. Since 1980, however, the Federal Reserve Board has annually processed HMDA data for the entire country into computerized form. This computerized lending data permit the examination of all regulated lenders over several years.

Utilizing computerized HMDA data, Woodstock Institute, in cooperation with the Metropolitan Washington Housing and Planning Association and the

Center for Community Change, has just completed a comprehensive study of 1981 and 1982 lending in the Washington, D.C. metropolitan area. The three volumes of this report provide for the first time a complete examination of residential lending in Washington, D.C. and its suburbs. The research report entitled "Where the Money Flows," presents a comprehensive statistical analysis of lending in terms of income, race and housing characteristics. Volumes II and III are designed to be used as a reference for community organizations, lenders and regulators interested in monitoring community credit flows. Volume II provides performance rankings for the 106 regulated financial institutions in the area. Volume III contains Community Lending Profiles for each of the 36 Advisory Neighborhood Commissions within the District of Columbia.

### FINDINGS

One would expect Washington, D.C. to be an easy place for lenders to make housing loans. The metropolitan area has one of the highest 1980 SMSA median household incomes in the country, \$23,344; it has experienced steady, expansive growth; and the federal government remains its major employer. In addition, the importance of having viable, healthy neighborhoods within the nation's capital would seem to rule out the possibility of systematic disinvestment.

The findings of this examination of lending distribution patterns in the Washington D.C. SMSA are surprising and disappointing. In particular, two conclusions demand serious consideration and thoughtful response. The first is that redlining of the central city continues, almost ten years after legislation was passed to eliminate this problem. The study found a marked difference in the flow of housing credit to the District when compared to the surrounding suburbs. In 1981, the District of Columbia received substantially less loan dollars per housing unit than the suburbs. In 1982, when credit became tighter and the overall amount of housing lending diminished, the gap widened; District census tracts lost proportionally more loan dollars than suburban tracts.

The second conclusion relates to the differences between the predictors of lending distributions in the District and those in the suburbs. In the suburbs, income level, or ability to repay a loan was the major predictor of where loans were made. In the District, by contrast, a much more disturbing pattern was observed. Contrary to expectations, the income level had almost no effect as a predictor of lending. Instead, analysis of the characteristics of District census tracts shows that the most important characteristic influencing lending in the District was race.

Specific results of the statistical analysis supporting these conclusions are presented below.

#### District versus Suburbs

The study compared the District with the suburbs on four types of lending: conventional single family mortgage loans, FHA and VA mortgage loans, home improvement loans, and multifamily loans. In every type of loan studied, District census tracts fared poorly when compared to suburban areas. For conventional single family mortgage loans made in 1981, census tracts in the District received an average of \$632 per housing unit while suburban tracts received an average of \$885 per unit. In 1982, lending in both areas decreased, but central city tracts lost an average of 22% while suburban tracts lost about 22% of loans.

Adding in FHA/VA, home improvement, and multi-family lending does little to change this balance. In 1981, District tracts received an average of 12 loans of all kinds per 1,000 housing units while suburban tracts received an average of 18 loans per 1000 housing units. The dollar amounts received highlight this difference further. An average city tract received \$538 per unit in 1981 while the average suburban tract received \$990. Thus, it is clear that more dollars flowed from regulated depository financial institutions into suburban areas than into central city areas.

Comparison of 1981 with 1982, when all lending decreased, shows an alarming trend. When lending became tighter and the overall amount of housing lending available from regulated lenders diminished, central city tracts tended to lose proportionately more lending than suburbs. Thus, the tightening of the money supply in 1982 hit the central city harder than the rest of the metropolitan area.

#### Predictors of Lending Distributions

Number of housing units. As might be expected, the most important housing characteristic influencing the distribution of lending was the number of housing units. Census tracts with more housing received more loans in both central city and suburbs in both of the years studied.

Age of housing. The greater number of older housing units in the city had little effect on loans received. The larger amount of new housing built in the suburbs between 1975 and 1980 was associated with greater lending in suburban census tracts. In the suburbs, more newer housing and more housing in general attracted more loans to census tracts in 1981. Unlike the central city, suburban housing market forces were more influential in distributing lending.

Owner occupancy. As expected, in both the central city and the suburbs, a higher number of loans per unit was found in census tracts with a higher percentage of owner-occupied housing. However, the relationship between owner-occupancy and lending is stronger in the suburbs than in the District. Proportionately as much housing finance flowed to central city neighborhoods dominated by rental housing as to neighborhoods dominated by owner-occupied housing. In the suburbs, the opposite was true. More housing finance dollars flowed to those neighborhoods with a higher proportion of owner-occupied housing.

Lending and Income. The central city in 1980 contained proportionately many more low-income census tracts than the suburbs; 58% of

The CHAIRMAN. Thank you very, very much.  
Mr. Fishbein.

**STATEMENT OF ALLEN J. FISHBEIN, GENERAL COUNSEL,  
CENTER FOR COMMUNITY CHANGE, WASHINGTON, DC**

Mr. FISHBEIN. Thank you, Mr. Chairman and Senator Graham. My name is Allen Fishbein and I'm the general counsel of the Center for Community Change and director of its Neighborhood Revitalization Project.

The Center is a national nonprofit group that provides research and assistance to low income community groups around the country. Additionally, for the past 10 years we've been monitoring the enforcement of the Community Reinvestment Act by the Federal regulators.

I want to concentrate my limited time today on agency enforcement and I hope my full statement will be included in the record.

The CHAIRMAN. It will be printed in the record in full.

Mr. FISHBEIN. Thank you.

**AGENCY ENFORCEMENT**

Mr. FISHBEIN. CRA has been plagued from the start by a weak enforcement. In fact, I think it would be accurate to say that the agencies literally have had to be dragged kicking and screaming into performing their responsibilities under the law.

It always has had very low priority, almost stepchild status, within the agencies. That is a condition that has gotten worse over recent years.

In fact, when you have the regulators here tomorrow, they will probably plead nolo contendere and cite the fact that there are other resource demands on their examiner time for the lack of effective enforcement.

I think there are really three numbers to keep in mind in connection with CRA enforcement by the regulatory agencies. The numbers are 74, 99 and 8. If you follow that and ask questions tomorrow about these numbers, it will be very useful. Seventy-four represents the 74 percent drop in examiner hours that were spent in consumer compliance, civil rights, and CRA enforcement between the years 1981 and 1984 by the OCC, the FDIC, and the Federal Home Loan Bank Board—a tremendous drop over a very short period of time. There was only a 25-percent drop during that same period of time by the Federal Reserve Board, however the Fed only regulates for CRA purposes 1,000 institutions, whereas those other agencies collectively regulate over 15,000.

Now the effects of that precipitous drop have been that there have been fewer exams and that examiners go on-site much less frequently than they have in the past. There have been steadily lengthening exam cycles. We now have a system that was instituted last year by the OCC which basically employs Russian roulette. For all the institutions that the OCC regulates under \$1 billion in asset size are put into a random sample for purposes of examinations. The OCC selects 16 percent of them each year, which means that on the average an institution will not be examined more than



the central city tracts had median incomes less than 70% of the SMSA's median income compared to only 12% of the suburban tracts. Yet some of the District's census tracts were wealthy (14%) and almost one-third were classified as middle income.

Just as the number of housing units would be expected to be closely related to the amount of lending in an area, the income of the people who live there would also be expected to be an important factor. It is often argued that lending does not occur in poor neighborhoods because the residents cannot afford to pay off the loans.

In the suburbs, this expectation was borne out by the study. Median family income was a strong predictor of lending in the suburbs in both 1981 and 1982. In 1981, each thousand dollars of median family income yielded suburban census tracts a net gain of .69 loans and \$86,000. By contrast, in the central city, income was totally unimportant in distributing dollars from regulated financial institutions to neighborhoods.

Lending and Minority Populations. Just as it was expected that number of housing units and the income of the population would be strongly associated with amount of lending, it was initially assumed that there would be no association between minority population and lending. Lending discrimination has not been an active issue in most cities for many years, and many minorities have attained middle class status and have purchased homes both in central city and suburban neighborhoods.

Contrary to expectation, however, the racial composition of central city tract areas strongly affected lending patterns. For each percent that minority population in a census tract increased, there was a net loss of .28 loans. This effect is very large. Comparison of two census tracts, each containing the city's average number of housing units but varying in their minority composition, shows that in 1981, an all-white tract received 21 more loans than a 75% minority tract. This difference increased over time. Over two years, each percent minority affected a net loss of about

\$42,000. So by the end of 1982, two comparable tracts differing only in their minority composition by 50% were over \$2 million apart in lending. In the suburbs, by contrast, minority population was not a predictor of lending.

#### STUDY METHODS

The study examined Home Mortgage Disclosure Act data for the most recent two year period available at the time of the study--1981 and 1982. The computer files containing these data also included housing and population data by census tract from the 1980 U.S. Census. In general, these data are used to show variations in housing credit flows and to examine the influence of particular neighborhood characteristics on the ways housing credit is distributed among neighborhood areas. Specifically, it was possible to show where each lender is or is not making loans and the overall pattern of lending throughout the SMSA; the correspondence between lending and housing characteristics such as owner-occupancy and age of housing; the relationship between lending and population characteristics such as income and race; and the unique influence of individual housing and population characteristics on variations in lending across the SMSA.

In order to answer questions about lending in the Washington, D.C. area, univariate analyses were carried out to ascertain the total and average volume of lending for the Washington area, for the central city, for the suburbs, and for each county. In addition, descriptions of the housing and social characteristics of census tracts with high, average and low amounts of lending were shown.

The bivariate analyses present correlations and contingency tables which show the correspondence between housing and social characteristics of census tracts, stratified by tract location in the city or the suburbs. These provide a description of lending patterns by tract composition and show the strength of the relationships between lending patterns and tract characteristics.

Finally, multivariate analysis was carried out which used regression techniques to look at the independent influence of different census tract characteristics on lending volume. By estimating equations which predict the volume of lending from the racial, housing and socio-economic characteristics of census tracts, the study was able to look at those characteristics which had the most and least influence on lending volume and to show how much of the variation in lending was explained by neighborhood characteristics.

#### CONCLUSION

Residential credit decisions are expressions of confidence -- in the borrower, the neighborhood, its housing and its future. Loans for purchasing and remodeling houses and acquiring and rehabilitating apartment buildings are essential to the vitality of neighborhoods and in turn to the health of the economy of cities and regions.

The implications of this study's findings are serious and far reaching. The effects of consistent unavailability of credit have been shown to have drastic negative effects on neighborhoods. This type of systematic disinvestment produces deterioration and abandonment of an expensive and necessary commodity -- housing.

Today, years after the echoes of the redlining struggles of the early 1970's, public policy makers' attention must be re-directed to the problems of disinvestment, particularly in the central city. We cannot afford to allow our cities, the heart of our economy, to be abandoned and left for the greener grass of the suburbs. Lenders, regulators and community groups must work together to develop new techniques to end racial bias in lending decisions, and to find new mechanisms to foster reinvestment in urban neighborhoods.

The research report and its companion volumes, Lender Performance Rankings and Community Lending Profiles, are meant to begin that process. Hopefully, they will serve as a benchmark against which future improvements can be measured.

#### EXECUTIVE SUMMARY

With this report, Woodstock Institute, in cooperation with the Center for Community Development and Design, a department of the School of Architecture and Planning, University of Colorado at Denver, completes an extensive examination of Home Mortgage Disclosure Act data for the Denver/Boulder metropolitan area for 1983 and 1984. During this period, banks and savings and loan associations lent over \$1 billion in the Denver region. This report describes where those dollars were invested and which lenders made the loans.

The research process was guided by the Community Reinvestment Task Force, a 25 member coalition of Denver area representatives from non-profit community development corporations, home counseling agencies, low-income and small business advocacy groups, local foundations, and municipalities.

Residential lending reports from 149 different financial institutions were used for this report. During 1983 and 1984, these lenders made a substantial investment in residential loans, an investment that totaled \$1.255 billion. Most of the loans were single family mortgages made by savings and loan associations. Although apartments make up 26% of the Denver region's housing stock, there were only 421 multifamily loans made for apartment buildings and these loans represented only 13% of the loan dollars. The majority of the multifamily lending was also done by savings and loan associations.

Between 1970 and 1983, the Denver metropolitan area had a phenomenal housing boom. Fifty-two percent of the housing stock existing at the beginning of 1984 was less than 15 years old. Although most of the new construction was in the suburbs and unincorporated areas around Denver, over 40,000 new units were constructed in the city during this 13 year period. Although it shared in the housing boom, Denver itself received slightly less than its proportionate share of the area's residential loan dollars and significantly fewer single family dollars per unit.

A closer look at lending within seven focus areas selected for individual analysis by the Community Reinvestment Task Force shows disparities in lending that are cause for concern. Three of the focus areas received far less than their expected share of lending.

Perhaps the most serious finding of this analysis of residential lending is the strong relationship between lending and race. Examination of the racial characteristics of the seven focus areas shows that there is a clear and inverse relationship between the percentage of blacks within a focus area and the amount of residential lending that the area received.

Experience with disinvestment has shown that low income and minority communities are often the first to suffer a lack of credit but the effect of the deterioration that results has an impact on other communities. A comparison of lender performance within 36 low income census tracts in Denver highlighted those lenders that are effective in servicing the credit

needs of their local communities. Ninety-one lenders, over 60% of those studied, made at least one loan in the targeted census tracts. Two lenders were particularly successful in lending to the targeted areas. World Federal Savings and Loan, the highest volume lender studied, made 191 loans totaling \$15.8 million in the targeted census tracts, and Western National Bank of Denver, a much smaller lender, made only 26 loans in the targeted census tracts, but these loans represented over 40% of its 1983-84 residential loan dollars. The lender comparison also identified lenders that could expand their service to low income communities.

Residential credit decisions are an expression of confidence — in the borrower, the neighborhood, its housing, and its future. This report shows that Denver area banks and savings and loan associations demonstrated a substantial commitment to the future of the Denver/Boulder metropolitan area through their 1983-84 residential lending. Woodstock Institute makes a series of recommendations for the Community Reinvestment Task Force to build on this commitment and work with lenders to find ways to address the particular credit needs of these communities and populations that are underserved. These include:

1. Community/lender discussions regarding the diverse and unique credit needs of various communities and populations should be initiated as a first step in identifying prudent loan products to address these needs.
2. Community/lender partnerships should be developed to design the most efficient, cost effective ways to provide long term financing for the credit needs of low income families, the elderly, and the disabled.
3. Those lenders successfully serving the credit needs in low income areas should be encouraged to assume a leadership role both in encouraging other lenders to reinvest and in participating in community development partnerships.
4. As subsidy dollars and other resources become more limited, it is imperative that ways be found to stretch their benefits as far as possible. Public and philanthropic dollars should be used to leverage private sector lending.
5. Foundations and local and state governments should ensure that their deposits encourage and reward reinvestment. The information in this report should be used as a criterion in evaluating institutional banking relationships; foundations should develop program related investment programs; and local and state governments should develop special linked deposit programs to encourage reinvestment initiatives for underserved populations.
6. Community based organizations and local policymakers should develop legislative safeguards to ensure that as the financial services industry changes and interstate banking becomes a reality, the residents of all communities continue to have access to affordable credit and deposit services.

TRACKING CHICAGO'S BUSINESS BUCKS:  
COMMERCIAL LENDING AND THE  
CHICAGO MUNICIPAL DEPOSITORY ORDINANCE

BY  
DAVID FLAX-HATCH

SEPTEMBER, 1987

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#### EXECUTIVE SUMMARY

Credit is essential for the economic health and vitality of any community. It makes possible the purchase and rehabilitation of housing and the creation, expansion and operation of the businesses which provide community residents with goods, services and employment. Despite the importance of credit to local businesses, no disclosure of business lending is required at the national level and only a handful of state and local governments have passed commercial lending disclosure laws.

The first law to require the disclosure of commercial loans was the Chicago Municipal Depository Ordinance (CMDO) passed in 1974 by the Chicago City Council. This ordinance sought to encourage fair and socially responsible investment within the City of Chicago and to ensure that financial institutions engaging in redlining and urban disinvestment did not benefit from the deposit of public funds. The Chicago Municipal Depository Ordinance serves as an important early model of reinvestment legislation which contains the disclosure requirements that allow for reinvestment evaluation and monitoring.

This report describes a project conducted by the Woodstock Institute which was designed to evaluate the Chicago Municipal Depository Ordinance's commercial lending data and to use it as a model for proposing commercial lending disclosure legislation.

Commercial loan data reported under requirements of the CMDO were examined from twenty-six banks applying for city deposits in 1986 and 1987. This represented one-third of Chicago's commercial banks, but over 80% of commercial bank assets. Together, these twenty-six banks reported approximately \$10.9 billion in commercial loans in Chicago over a two year period, an amount significantly greater than all other types of lending. Commercial loans accounted for 85% of all dollars lent.

Two-thirds of all commercial loan dollars went to businesses in the suburbs. The commercial loan dollars that remained within the City of Chicago were highly concentrated. Seventy percent of commercial loan dollars went into twelve of Chicago's 700 census tracts, all located in or near the Loop. Generally, large banks and banks located downtown were more likely to lend to the suburbs and downtown while small banks and banks located in neighborhoods were more likely to lend in Chicago's neighborhoods.

While the commercial lending data reported under the CMDO is useful in portraying the magnitude of business lending in Chicago and in identifying commercial credit flow patterns, including

the extreme concentration of credit to a small part of the city, the CMDO suffers from a number of shortcomings which limits its usefulness in addressing the goal of promoting reinvestment in Chicago.

First, the CMDO lacks any clear statement of purpose or direction for use of the data as a tool for reinvestment. Therefore, the data is collected by the City of Chicago but not used in its economic development planning activities.

Second, there were a number of errors, omissions and other problems with the quality of the CMDO data. These included omissions by the banks of portions of the data required, inconsistent reporting time periods and units and incorrect census tract numbers.

Third, there is some confusion as to whether loans are being reported in the census tract of the corporate headquarters or the location of use. This distinction is very important to community users of the data and other economic development practitioners.

Fourth, there is little monitoring or screening of the data collected by City staff, and therefore errors have continued over many years.

Finally, the data is difficult to access by the public, although much of its use has been by public interest and community organizations using the information for economic development planning and Community Reinvestment Act enforcement.

After analyzing commercial lending data collected under the CMDO, the Woodstock Institute recommends the following adjustments to the CMDO model for future commercial lending and other lending disclosure programs:

- The reinvestment purposes of disclosure laws should be clearly stated and the use of the data in addressing the reinvestment purposes should be well-defined. The agency collecting the data should regularly review the information submitted by the banks, conduct periodic analyses of the information collected, and use the information as the basis for evaluating reinvestment performance.
- All terms and items of disclosure should be clear, specific, and well-defined.
- A standard format for reporting data should be mandated and enforced.
- Consistent monitoring procedures should be carefully followed.

- Disclosure data should be accessible to the public in a convenient form.

The CMDO data paints a disturbing picture of commercial lending in Chicago. While its findings may be viewed as provocative rather than conclusive, the lending patterns described in this report cause concern and raise serious questions that can best be answered by broad and effective commercial lending disclosure legislation. The Chicago Municipal Depository Ordinance serves as a model for future efforts to draft and enact such legislation, through both its strengths and its shortcomings.



once every 6 years and, in some cases, with the luck of the draw, it could be 10 or 15 years or more before an institution is examined.

And of course, examiners spend increasingly less time on the CRA portion of the examination process.

The lengthening of exam cycles and reduced examiner hours mean weakening the deterrent factor, because CRA and the civil rights laws really require routine on-site examinations to make sure that the institutions are fulfilling their responsibilities. It also means that the examiners in their rush miss pretty straightforward technical violations of the existing law. In our written testimony, we cited some basic technical violations that community groups found but the regulatory agencies in their own examination process apparently were never able to uncover.

The reduced examiner time on CRA also means that the agencies do not contact community groups and public officials as part of an on-site examination and evaluation of an institution's performance. And without this kind of information, they are really assessing only one piece of the equation—the lender's side, without knowing what the community deems to be important credit needs, nor an evaluation of how well those institutions are serving the needs.

The second number is 99. As the chairman referred to in his opening statement, 99 percent reflects the number of institutions that received a passing grade among the banking agencies last year. The figure was 84 percent by the Federal Home Loan Bank Board.

Now that figure varies year to year. It will drop down to maybe 97 percent and then it will go up again to 99 percent, but the figure has been fairly constant in the 1980's—99 percent of the institutions are assured of receiving a passing grade.

Wholesale grading inflation really has hampered the effectiveness of CRA enforcement. You will hear that the agencies view this as a sign of success. I mean, they turn that around and say that the fact that 99 percent of the industry is receiving passing grades shows that they are doing a good job.

Well, I think that's a rather ludicrous argument. Particularly in terms of the quality and the frequency of the examination process it really doesn't hold up under close scrutiny.

More importantly, once you assign 99 percent of the commercial banks a satisfactory rating, you have destroyed the encouragement aspect of CRA, which was designed to be a very important part of enforcement—the nudge factor, as you, Mr. Chairman, referred to it in your statement this morning.

Another problem with CRA enforcement is that the current rating system is inadequate. There is literally no substantive basis for evaluating and differentiating between performance levels of the institutions. Ten years after the law was passed, it is basically left up to individual examiner discretion to determine what is a one, two, three and so on rated institution. This has led to very inconsistent and uneven exam reports both within the same agency in different parts of the country and certainly between agencies.

Also, there have been reports of limited support for the examiners by their own supervisory personnel. I have heard examiners tell me that they've been forced to upgrade the ratings that they wanted to assign to institutions as a result of pressure they re-

ceived from their supervisory personnel. These supervisors tend to be safety and soundness personnel.

The third number, 8, is the number of denials over the 10 years of CRA. There have been in excess of 40,000 applications. There have been about 250 CRA protests filed during that time. Eight denials, all of them branch applications, to my knowledge, none of them involving mergers.

So in effect, the limited sanction of CRA is not being used. The industry has acknowledged the sanction to be a paper tiger, so there is no incentive through the CRA application review process for institutions to improve their record.

The commitment process is what the agencies will claim they use as an alternative—instead of denying an application, they will seek commitments. When we look at these commitments, they tend to be very open-ended, very general. Ms. Smith mentioned in her testimony, there is very little follow-through by the agencies to even determine whether the institutions are living up to the commitments that they themselves have made to the regulators in order to get CRA approval.

#### RECOMMENDATIONS

In terms of recommendations, they are really four fold. One is expanding the regulatory enforcement resources. We think examination cycles should be on an 18-month rotating basis for CRA and civil rights purposes, that are conducted by consumer examiner.

Second, there needs to be greater agency accountability. We think the CRA evaluation and rating should be disclosed to the public so the public can actually assess how well local institutions are reinvesting in their community.

Third, we call for reform of the CRA rating system. Switch to a revised scale that will be a comparative scale so that examiners can evaluate institution performance against a peer size institution and establish meaningful standards for really determining what the distinctions are between a one, two and a three rated institution.

Last, we would hope that the CRA protest process would be strengthened, that applications by institutions with poor records would be denied and citizen access expanded.

But I must say in closing, Mr. Chairman, that this is not going to occur—and history has shown this to be the case—without direction from this committee, that direction—probably legislative direction is necessary if these laws are going to be effectively enforced.

Thank you.

[The complete prepared statement of Allen J. Fishbein follows:]

TESTIMONY BY

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on

THE IMPLEMENTATION AND ENFORCEMENT OF THE  
COMMUNITY REINVESTMENT ACT OF 1977

BEFORE

THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
UNITED STATES SENATE

MARCH 22, 1988

Good Morning, Mr. Chairman and members of the Committee. My name is Allen J. Fishbein and I am General Counsel of the Center for Community Change and Director of the Center's Neighborhood Revitalization Project. I am also a former member of the Federal Reserve Board's Consumer Advisory Council.

The Center for Community Change is a national, non-profit, organization, based here in Washington, D.C., that provides research and training to low income and minority community groups in the areas of community development, neighborhood reinvestment, and consumer credit. The Center has a long-standing interest in monitoring the implementation of the Community Reinvestment Act and other federal anti-disinvestment regulatory requirements. In addition, we have provided training and lectured on CRA at conferences and seminars sponsored by various banking industry trade associations as well as by the federal financial institution supervisory agencies. We have also published a series of publications in conjunction with the U.S. Conference of Mayors and the U.S. Department of Housing and Urban Development on neighborhood reinvestment strategies and techniques for assessing community credit needs.

I appreciate the opportunity to present before you the views of the Center for Community Change on the implementation and enforcement of the Community Reinvestment Act (CRA). These hearings come at a critical point in the enforcement of CRA. It has been a decade since CRA was enacted. While the Act has

accomplished a great deal, it has been crippled by weak enforcement almost from the outset. Oversight and the continuing interest of this Committee is vital to ensuring that the federal agencies charged with the supervision of the banking industry enforce the law in the manner in which Congress intended.

#### Summary

During the 1960s and 70s increasing public attention focused on discriminatory mortgage lending practices that restricted the flow of credit to the nation's cities. Disinvestment by banks and other depository lenders was increasingly viewed as a major contributor to neighborhood deterioration and necessitated the expenditure of public resources to revitalize these areas. As a result, Congress enacted a series of regulatory reforms which were designed to curb neighborhood discrimination and disinvestment by financial institutions.

And indeed, legislative measures such as the Home Mortgage Disclosure Act (1975) and CRA has helped to reduce many of the overt forms of lending discrimination that were once all too prevalent within the lending industry. Moreover, the enactment of these laws have helped to improve communication between lenders and their local communities and to stimulate the formation of many successful local reinvestment partnerships involving lending institutions, local governments, and community groups.

Yet, despite the successes that have occurred, it is clear that the effectiveness of CRA has been limited due to weak enforcement by the federal agencies charged with the responsibility for implementing the Act. Unfortunately, the picture that emerges is that CRA is working almost in spite of the regulators and not because of them. To the extent the law has stimulated new lending in urban neighborhoods and slow growth rural communities it has been a tribute to the efforts of hundreds of grass roots community groups, which have often been left to perform the role of de-facto bank examiners in the face of regulatory inaction.

Clearly, there is a growing need to strengthen the implementation of CRA. Lending institutions are gaining greater sophistication in presenting their CRA records to agency examiners and responding to CRA complaints by community groups. The result is all too frequently financial institutions are doing a better job of packaging poor records so that they look good to regulators rather than making substantive improvements in lending performance. Whatever modest improvements in enforcement occurred over the first few years after CRA was enacted have been virtually undone a result of agency indifference over the past five or six years. And we fear that this trend will continue without strong and immediate action by Congress.

Moreover, the rapidly accelerating pace of financial deregulation appears to have unleashed new disinvestment forces

as banks increasingly cater to upscale customers. These new trends are combining to offset many of the gains that have been achieved in recent years. Existing regulatory safeguards, such as HMDA and CRA, may not be sufficient to curb the adverse impacts of deregulation.

We believe that the implementation of CRA can be strengthened through four avenues of reform: 1) Expanding regulatory enforcement efforts; 2) Greater agency accountability and public disclosure requirements; 3) Reforming the CRA rating system; and, 4) Reforming the application review and CRA protest process.

#### The Importance of CRA to Local Communities

The enactment of the Community Reinvestment Act in 1977 represented an important turning point for nation's older urban neighborhoods and for the modest income and predominately minority people who tend to reside in these areas. The Act spelled out the responsibilities of federally regulated financial institutions to serve their entire local communities and not just selected areas.

CRA states that depository institutions (commercial banks, savings banks, and savings and loan associations) have a continuing and affirmative obligation to help meet the credit needs of the local communities in which they are chartered. Through this Act, Congress directed the four federal supervisory agencies that regulate banking (Federal Reserve System, Office of the

Comptroller of the Currency, Federal Deposit Insurance Corporation, and the Federal Home Loan Bank Board) to encourage financial institutions to help meet local community credit needs, consistent with the safe and sound operation of such institutions.

Additionally, CRA requires the regulatory agencies to assess each institution's record in meeting the credit needs of its entire community, including low and moderate income neighborhoods, and take these records into account when acting on requests by these institutions for permission to open new deposit facilities or to merge or acquire one another.

Passage of CRA and HMDA, which required depository institutions to disclose the geographic location of their housing related lending, have been instrumental in helping to curb some of the more overt forms of discrimination against neighborhoods. For example, "redlining," the practice whereby lenders shun certain geographic areas on an arbitrary basis, or impose more restrictive terms and conditions on loans made to these areas, probably has been reduced in the decade since CRA went into effect. Yet, community groups report that more subtle loan policies remain in place that serve to limit lending to urban neighborhoods and slow growth communities. These charges are supported by recent research which indicates that wide disparities continue to exist in many areas in lending levels between suburban and largely white communities and inner-city and predominately minority counterparts.



Another important feature of CRA is that it provides community groups with standing to raise complaints about the lending performance of local financial institutions with the regulatory agencies. Thus, citizens can seek to have the supervisory agencies deny a pending expansion application on the grounds an institution's CRA performance is inadequate. While outright denials of protested applications rare, especially in recent years, CRA protests have sometimes resulted in settlement agreements between applicant financial institutions and the local protesting party.

These written settlement agreements, which are entered into voluntarily by the parties, often involve commitments by the financial institution to improve various aspects of its lending record. Unquestionably, the CRA complaint process has become the primary means to bring to the agencies' attention deficiencies in the CRA performance of applicant institutions. It will continue to remain central to CRA enforcement, at least for as long as the agencies' own enforcement efforts remain weak.

A 1985 study conducted Calvin Bradford and Paul Schersten on behalf of the Hubert H. Humphrey Institute of Public Affairs, of the University of Minnesota, entitled, A Tool For Community Capital: Home Mortgage Disclosure Act, 1985 Survey found that over \$3.7 billion in loan funds had been committed to low and moderate income communities as a result of these CRA agreements. Since the Humphrey Institute study was published, my organization

and others have estimated that at least \$1.5 billion of additional loan commitments have been made, bringing the overall total to in excess of \$5 billion. These reinvestment commitments are critical to the vitality of these areas, coming at a time when the public resources available for community development and revitalization activities are dwindling.

And indeed, there are signs that some financial institutions are becoming more involved in the rehabilitation of low income housing and promoting economic development in urban neighborhoods. For example, according to John West, Executive Vice President of Mercantile Bank of St. Louis:

Working with neighborhood groups has generated \$250 million in loans at market rates with almost zero losses . . .  
The loans have leveraged 3 to 4 times in total development costs mostly because of federal subsidies such as CDBG. Over 10,000 new or rehabbed housing units have been developed, which is 8% of the city's stock."  
(As quoted in Housing Rehabilitation Programs, Techniques, and Resources, U.S. Department of Housing and Urban Development, 1987, at p 2)

Perhaps more importantly, CRA has helped to transform what was often an acrimonious debate over whether lending institutions engaged in redlining into a more constructive dialogue about the reinvestment needs of local communities and strategies for addressing these needs. The issue is shifting from "whether" financial institutions have a role in helping to meet the credit needs of low and moderate income communities to "how much" they have done.

As the Chairman and other members of the Committee know, this represents an important progression from the days when the merits of CRA were first debated in the halls of Congress.

#### Continuing Credit Availability Problems

Despite the many success stories, research continues to indicate that credit gaps still exist in certain communities, especially low and moderate income and predominately minority areas. The lack of available capital is a serious impediment to efforts to upgrade the housing stock, expand homeownership opportunities for modest income families, and provide employment opportunities through business expansion in these communities.

In-depth studies of mortgage lending patterns in five major cities over the past several years have reached startlingly similar conclusions. Twenty years after the passage of the Fair Housing Act, race is a significant factor in determining where mortgages are and are not made.

The five cities studied were Chicago, Baltimore, Washington, D.C., Philadelphia, and Denver/Boulder. Three of these studies conducted by the Woodstock Institute, a well respected research organization which specializes in lending research (Washington, D.C., Denver/Boulder, and Chicago). All five of the studies were based on data provided by the federal Home Mortgage Disclosure Act, which discloses the number and total amount of real estate loans made by a lender, itemized by census tract. Using census

data on race, income level, and other characteristics, each of the studies discovered patterns in the flow of mortgage credit that were specific to the individual city. See Attachment 1

But, a common theme emerged from all five studies: when other factors were held constant, minority neighborhoods received far fewer mortgage loans than expected. Perhaps the most dramatic findings were in Washington, where the study conducted by the Woodstock Institute found that "the most important characteristic influencing lending . . . was race."

These studies raise important questions about whether discrimination is occurring on a prohibited basis in urban mortgage markets. The banks and S&Ls surveyed in these studies were providing significantly fewer loans to potential homebuyers in predominately minority neighborhoods than to homebuyers in predominately white neighborhoods. While the lending studies do not necessarily demonstrate that the financial institutions in these cities are engaged in willful discrimination, the data does suggest that these institutions may have policies and practices in place that have a discriminatory "effect" of denying or restricting mortgage dollars to minorities and minority neighborhoods.

Recent experiences by private fair housing groups shed some light on the kinds of policies and practices that lenders employ that produce the disparities documented in the recent statistical research. Since 1985, the Toledo Fair Housing Center has filed

at least six civil rights lawsuits based on discriminatory mortgage lending practices. In addition to outright racial bias, the Fair Housing Center has found that a number of policies, even if they are applied to all borrowers, have a disproportionate impact on minority homebuyers and neighborhoods:

- o Minimum loan size requirements that are higher than the average price of homes in minority neighborhoods.
- o Tiered interest rates that are based on the loan size; the smaller the loan, the higher the interest.
- o Differential loan-to-value ratios for home equity loans depending on the neighborhood; for example, lending up to 80% of the owner's equity in a non-minority area but only up to 40% or 60% of the owner's equity in an older, inner-city, minority neighborhood.

Appraisals have also been a factor in some of the cases in Toledo, as well as in some cases filed by the Northwest Indiana Open Housing Center in Gary. In these cases, appraisers employed by the lender have undervalued homes in minority neighborhoods. Based on the appraisal, the lender has then refused to lend the borrower enough money to buy the house.

These lawsuits seem to have heightened public awareness in Toledo about how loan policies may be biased against certain types of borrowers and neighborhoods.

Publicity about the cases has encouraged others who have complaints about discriminatory lending practices to come forward.

In one year, the Toledo group received 48 lending complaints, more than the U.S. Department of Housing and Urban Development received nationwide in the same time period.

Continuing credit availability problems are also reflected in the increasing numbers of CRA protests which have been filed in recent years. Last year, the federal regulatory agencies received over 50 CRA protests, the largest number that have ever been filed. The Federal Reserve Board data indicate that there has been a ten-fold increase in CRA protests since 1984.

Another important factor in the rise of CRA activity is growing concern about the impact that financial deregulation is having on low and moderate income and slow growth communities. Interest rate decontrol has intensified competition for deposits, and many financial institutions have begun aggressive marketing of their services to an upscale clientele - affluent individuals and mid-size corporations. This creates the perception, often accurate, that they are not interested in serving less affluent individuals and neighborhoods. Another side effect of deregulation is that depository institutions are charging higher fees for their services: checking accounts, savings accounts, money orders, stop payments, returned checks, etc. For many low income people, the result is that they can no longer afford to maintain a bank account. Thus, people who were once a part of the banking system are being forced out, and some young people are discouraged from ever becoming part of the system. The

cumulative effect of these changes can be extremely detrimental to low and moderate income neighborhoods.

Interstate banking is another aspect of deregulation that causes concern. If management decisions are made in distant places, how can they be responsive to local needs and conditions? When local banks have been bought by large regional or national holding companies, community groups have seen many rapid changes occur. The bank may begin to offer less favorable loan terms and conditions, intended to standardize the credit process across all of the holding company's subsidiaries. A different mix of loan and deposit products may be available, which may not be as suitable in a specific city as the products that had been offered prior to the merger. Standardized underwriting criteria may be put into place, criteria that fail to take into account special local conditions. Personnel changes occur, removing familiar faces from local branch offices. Thus, an institution may become less responsive to local needs and conditions. Ultimately, local funds may be siphoned off and invested in other cities, regions, or nations while ignoring the needs at home.

Many of the CRA protests that have been filed in the past few years involve interstate banking applications, in which community groups seek to have the acquiring institution spell out its commitment to serve the credit needs of low and moderate

income areas of the new market it is attempting to enter. See Attachment 2.

#### Significant Improvements Are Needed in CRA Enforcement

Several factors have contributed to the weak enforcement of CRA by the regulatory agencies. First and foremost, however, is that enforcement in this area has generally had a low priority within each of the federal supervisory agencies. CRA and consumer enforcement are clearly viewed as subordinate to the agencies' other responsibilities. The low priority is reflected by the increasingly limited resources that are allocated by the agencies to these areas.

In fact, CRA was enacted in recognition of the need to change the basic mindset of the supervisory agencies and broaden their view of their regulatory responsibilities over the financial institutions they supervise. The Senate Banking Committee's final report on the legislation that was to become CRA stated:

The need for (this) new legislation arises because regulating agencies lack systematic, affirmative programs to encourage lenders to give priority to the credit needs of their home areas.

The enactment of CRA was a congressional rebuke to the regulators for their unwillingness to use their existing regulatory authority to encourage financial institutions to better meet the credit needs of their local communities. And indeed, the agencies

have had to be dragged kicking and screaming every step of the way.

Unfortunately, from the very outset the agencies have resisted full implementation of the congressional directive embodied in CRA. The U.S. General Accounting Office strongly rebuked the supervisory agencies' consumer compliance program in a report published in 1981. *Examinations of Financial Institutions Do Not Assure Compliance with Consumer Credit Laws*, U.S. General Accounting Office, GGD-81-13, 1981. The GAO report specifically singled out for criticism the agencies' CRA enforcement: "... we found indications that (CRA) examinations were inadequate to determine substantive compliance or noncompliance." (GAO Report, at p. 14)

My testimony today does not focus on the civil rights responsibilities of the regulatory agencies, which to a certain extent intersects with their CRA responsibilities. It should be noted, however, the agencies' enforcement of the antidiscrimination laws in the mid-1970s was termed "pretty disgraceful" by Chairman Proxmire. *Implementation and Enforcement of Fair Mortgage Lending Laws and Regulations*, Hearings before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, 96th Congress, First Session, 1979, at 1. Moreover, agency footdragging in the implementation of fair lending enforcement led eleven major civil rights organizations back in 1976 to take the four regulatory agencies to court (*National Urban League, et al. v. Office of*

*the Comptroller of the Currency, et al.*, CA 74-718, 1976). The lawsuit eventually resulted in a series of out-of-court settlement agreements between the parties, in which three of the four agencies (the lawsuit against the Federal Reserve Board was dismissed for lack of standing by the plaintiffs) agreed to develop and institute data collection and analysis systems to help to detect discriminatory lending practices, programs for training examiners on lending discrimination, and the appointment of civil rights specialists in each of the agencies. Unfortunately, these programs have been curtailed and the settlement agreements have expired.

In 1982, the Federal Reserve Board, to its credit, directed the Consumer Advisory Council to investigate the agency's implementation and enforcement of CRA. The Council issued its final report in March, 1983 which included some 50 recommendations for improvements in CRA enforcement, the most significant of which have yet to be implemented by the FRB. The report concluded: "A higher priority for CRA is needed in regard both to attitude and to effort..." The Federal Reserve's Implementation of the Community Reinvestment Act of 1977, CAC, 1983, at p.3.3.

Most recently, the Office of the Comptroller of the Currency held a series of "customer key issues meetings" in 1985. These meetings convened community and consumer leaders in each of the OCC's regional districts. The views presented by those attending



these meetings were remarkably similar. They felt the agency needed to make substantial improvements in CRA enforcement.

Unfortunately, CRA enforcement has not improved despite the criticisms contained in these various studies. Moreover, there are numerous signs that it has gotten weaker.

Regulatory resources for CRA enforcement, as you will undoubtedly hear from the regulators tomorrow, have been restricted as a result of budget limitations. The heavy emphasis on safety and soundness concerns has also been a factor. These competing demands have resulted in a substantial diversion of resources away from CRA and consumer enforcement. Further, the authorization of expanded banking powers and the substantial new demands on the supervisory resources of the agencies will inevitably lead to additional pressures to divert resources away from CRA and consumer enforcement.

There are two major components of CRA enforcement: 1) the examination function; and 2) the application/protest process. Agency enforcement in each of these areas has significantly eroded over the past eight years and is in need of substantial reform.

#### Current Deficiencies in the CRA Examination Function

The CRA compliance examination lies at the heart of the four agencies' enforcement program. The Act requires each regulator in connection with its examination of a financial institution to assess the institution's record in meeting the

credit needs of its entire community, including low- and moderate-income neighborhoods. In making this assessment, the agencies rely on twelve factors, which they have promulgated jointly. After assessing the factors, the banking agencies' examiners assign a numeric rating to the institution, based on a five-tiered scale (#1- outstanding, #2- satisfactory, #3- less than satisfactory, #4- Unsatisfactory, #5- Substantially inadequate). The FHLBB uses a slightly different system, with 3 positive ratings and only 2 negative ones. The CRA compliance examination and the rating that is assigned to the institution are required to be taken into account whenever the appropriate regulator acts on an institution's expansion application. The rationale behind this system is that a lending institution receiving a poor assessment will be encouraged to improve its lending performance or risk having its expansion application denied or other sanctions imposed by the regulator.

Unfortunately, the system has not worked this way. In fact, the current CRA examination is an ineffective tool for measuring lender performance for two reasons: Too few resources are committed to this area; second, the current CRA rating system is flawed and cannot be used to measure accurately performance levels by financial institutions. Let me discuss each of these two points in additional detail.

#### A. Too Few Resources Are Allocated to the CRA Examination Process

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The declining emphasis that CRA and consumer enforcement has received from the agencies can be measured by the dramatic decline in examiner hours allocated to these areas which has occurred. According to data compiled by BankWatch, a well respected public interest organization, the total examiner hours per year on CRA and consumer exams fell at the OCC from 300,528 in 1981 to 84,315 in 1984, at the FDIC from approximately 450,000 in 1981 to approximately 112,000 in 1984, at the FHLBB from 57,807 in 1981 to 13,566 in 1984, and at the FRB from 106,235 in 1981 to 79,786 in 1984. The combined examiner hour totals for the OCC, FDIC, and FHLBB fell from approximately 808,335 in 1981 to only approximately 209,881 in 1984, a precipitous decline of 74%. In contrast the decline in examiner hours at the FRB was a more modest 25%. The OCC, FDIC, and FHLBB collectively are responsible for examining about 16,000 banks and thrift institutions, while the FRB only supervises about 1,000 banks. The decline in total examiner hours spent on CRA and consumer compliance exams reflects both a decline in the number of exams conducted per year and a reduction in the average number of examiner hours per exam. While the agencies may claim that these figures have increased somewhat since 1984, it is unlikely that they come anywhere near approaching the 1981 examiner hour levels.

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Declining resources are also reflected in the lengthening examination cycles employed by the agencies. When the interval between exams, especially CRA and consumer exams, becomes too long the deterrent value of the examination process is reduced and the ability of the examiners to "encourage" improvements in lender performance is also constrained. The agencies have lengthened their exam cycles in recent years.

The FRB currently performs CRA exams at banks once every 24 months and more frequently for banks with less than satisfactory ratings. During 1981 to 1986 the FRB operated on an 18 month CRA and consumer exam cycle. Prior to 1981 the FRB operated on a 12 month exam cycle.

Last year, the OCC stopped conducting regularly scheduled CRA and consumer exams at national banks with less than \$1 billion in assets. Instead, the OCC went to a "Russian roulette" approach for exams, selecting a random sample each year of approximately 16% of the banks in this size category and conducting a multi-function compliance exam, which includes CRA and consumer compliance. Consequently, the average interval between exams is six years for banks in the random sampling system. However, the sampling system also means that some banks may not be examined for 10 or more years.

The FDIC currently has as its goal examining each state chartered nonmember bank it supervises once every 3 years.

However, in 1986 the FDIC conducted exams at only 1 out of every 6 banks.

The FHLBB has a goal of examining each S&L once every three years, yet at some Home Loan Bank Districts the exam cycle may be as long as 6 years.

The regulators will say that they have begun to place a greater emphasis on off-site monitoring of the banks they supervise. Regardless of the merits of this approach for the safety and soundness aspects of examination, off-site monitoring is not an adequate substitute for on-site exams for CRA and consumer compliance. CRA requires examiners to make judgments about the adequacy of a financial institution's lending performance. The Fair Housing and Equal Credit Opportunity Acts, which require examiners to review lender records for possible discrimination, also necessitate on-site exams.

The outbacks in the resources allocated to CRA examinations have contributed to the declining quality of the exam reports and may help to explain why community groups routinely spot simple technical violations of the regulations that should have been detected easily during the compliance exams. Here are a few examples:

o The Brooklyn chapter of ACORN (Association of Community Organizations for Reform Now) found that both the Bank of New York and Irving Trust bank were in violation of the CRA regulations, by delineating their lending communities in a way that

arbitrarily excluded low and moderate income areas in New York City. ACORN was able to uncover this violation by plotting the geographic distribution of their lending, after BNY had applied to the FHB to acquire Irving. The FHB's order approving the acquisition required BNY to reassess both its and Irving's local community delineations in the New York City area. Both institutions had apparently employed these gerrymandered community delineations for many years. How come the violation wasn't detected by the routine compliance exams?

o Louisiana ACORN was responsible for detecting another clear violation of the CRA regulations. Under CRA each financial institution must publish and update annually a CRA Statement, which must include a list of the types of credit the institution is prepared to extend to its entire delineated lending community. Last year, Louisiana ACORN discovered that the First National Bank of Commerce did not list home purchase loans in its CRA Statement, a statement which appeared to be essentially unchanged since 1979. Yet, in reviewing the Home Mortgage Disclosure data reports for the years 1984-86, the organization found that the bank makes on average one home purchase loan a week. This is a clear violation of the CRA regulations; unfortunately, it is another example of one that was not corrected by the OCC, which supervises the bank.

6 In reviewing the mortgage lending record of the Leader Federal Savings and Loan Association, the Shelby County Community Reinvestment Coalition (Memphis, TN) discovered that the institution had consistently submitted inaccurate and incomplete Home Mortgage Disclosure statements to the Federal Home Loan Bank Board. The S&L's disclosure statements neglected to break out the loan data by census tract, a clear violation of Regulation C (the regulation implementing HMDA). Moreover, upon further investigation the group discovered that the institution had neglected to submit any 1985 HMDA report for its lending in Nashville. Again, it appears the FHLBB did not spot or overlooked what was a clear violation of law.

These examples underscore the consequences of the years of neglect of CRA enforcement and the inevitable decline in the quality of enforcement which has occurred. And of course, once again community groups are required to step in and serve as ~~de facto~~ bank examiners to make up for the deficiencies in the examination process. While these local groups have accomplished a great deal they have neither the resources nor the access to the necessary information about lending records of their local institutions to conduct comprehensive CRA audits. This is a function that is more suitably left to the regulatory agencies.

The weakness in the examination process is also attributable to the lack of a full-time specialized consumer examiner force.

Currently, the FRB is the only one of the agencies to use consumer examiners for CRA, civil rights, and consumer compliance exams. The other agencies continue to use all-purpose examiners to conduct these examinations in addition to their other safety and soundness functions. These all-purpose examiners lack the necessary training, know how, and sometimes commitment to perform the CRA and consumer compliance examinations. The OCC, FDIC, and FHLBB should be required to institute a separate specialty area for CRA and consumer enforcement, along with separate career paths. Consumer and reinvestment specialists should be recruited based on the particular skills and expertise which are necessary to perform these types of exams adequately.

#### B. The Current CRA Rating System Does Not Lead to Improved Lending Performance

There is widespread dissatisfaction with the current CRA rating system from both community groups and financial institutions alike. Community groups complain that bank examiners refrain from making tough judgments about the adequacy of the financial institutions they examine, while financial institutions complain that the grading system is arbitrary with few substantive standards, failing to reward the truly outstanding performer compared to the rest of the pack. There is a great truth to all of these complaints.

Although ostensibly a five-tiered numeric rating system, the CRA grading system is little more than a pass/fail system, with virtually all of the institutions that are examined assured of a passing evaluation. Data supplied by the agencies indicates that nearly all the banks and most of the thrifts examined in any year receive passing grades. For example, nearly 99% of those banks examined in 1986 received passing grades (#1 or #2) CRA ratings, while about 96% of the thrifts examined received passing grades. In 1985, almost 99% of all thrifts examined received favorable ratings. So it would appear that the CRA rating process does little to differentiate between performance levels of institutions.

The rating inflation is even more widespread for the largest lending institutions. For example, the data indicates that in 1983, only 1 out of the 345 largest banks received a failing grade (the institution received a #3). These institutions collectively control about 62% of the assets within the banking system. Similarly, in 1984, only 2 out of the 202 largest banks examined received poor grades (they both received a #3 rating), while in 1985, 2 of the 239 largest commercial banks received #3 CRA ratings. The figures are comparable for the FHLBB's exams, where the largest thrifts seldom receive a failing CRA grade.

Unquestionably, CRA rating inflation has hampered the effectiveness of the examination process. Examiners routinely assign satisfactory or better ratings to the institutions they

examine without any real basis for such conclusions. What is more, the overwhelming prevalence of passing ratings makes it more difficult to down-grade an institution in subsequent exams. It also results in increased use of the CRA protest process by community groups, since the rating system is viewed with great distrust by them.

The pass/fail nature of the system robs lenders of any real incentive to improve their performance once they have received a passing grade. The prevalence of the compliance vs. non-compliance mentality for CRA exams was strongly criticized in the Consumer Advisory Council study, which recommended at the FRB revise its current rating system to provide for three passing grades instead of two. CAC Study, at. p. 4. The CAC found that the FRB's examiners were essentially using a two-tiered rating system, which did not provide an ample opportunity to distinguish between the different lender performance levels.

The fact that the CRA rating system has deteriorated into a pass/fail system is not surprising. The examiners approach CRA enforcement much as they do other areas of compliance, seeking to determine whether an institution is in compliance with the requirements of the law. While this is satisfactory for certain other consumer protection laws, which feature detailed procedural requirements for lenders, it is not appropriate for CRA enforcement purposes. CRA requires examiners to distinguish between performance levels of the institutions they examine as well as



to determine whether they are in compliance with specific regulatory requirements.

The CRA examination process is also hampered by the uneven and often inconsistent manner in which financial institutions are evaluated for CRA purposes. I have had several opportunities to review exam reports for two agencies, the FRB and the OCC. I examined an extensive sample of FRB exam reports in my capacity as a member of the CAC's committee which studied the agency's enforcement record. I also have had the opportunity to review OCC exam reports. I found the quality of these exams and the methodologies employed by the examiners often varied between examiners and regions. While the FRB has made some improvements in standardizing its approach to exams, it is unlikely this has occurred with the other agencies.

One of the conclusions I reached was that the failure of the agencies to develop substantive and quantifiable standards for measuring the performance of lenders contributed to the inability of the examiners to make tough judgments about lender performance. The current examination procedures for all four agencies provide too little guidance to examiners to help them distinguish between the performance levels of different institutions and make decisions about whether to assign a lender a #1, #2, or #3 rating. In assigning CRA rating the banking agency examiners are supposed to be guided by the Uniform

Interagency CRA Assessment Rating System. The FHLBB has a similar rating system.

The Uniform CRA Assessment Rating criteria instruct examiners to weigh and evaluate performance according to how well the institution meets the descriptive characteristics for each rating category. Thus, institutions having a "strong record of meeting community credit needs" should be assigned a #1 rating. The rating an institution receives is a composite rating based on numeric ratings it receives in the five CRA performance categories (the 12 assessment factors are grouped into five performance categories for rating purposes). Yet, even within the five performance categories examiners are provided with little guidance on how to calculate performance levels. Phrases like, the "institution has actively undertaken steps to determine community credit needs" or "the institution has taken affirmative steps to become aware of the full range of community development programs" are used to describe a #1 rated institution. On the other hand, a #2 rated institution "is one which merely "has undertaken activities to determine its community credit needs" or where the "institution is aware of community development programs . . ." Thus, the apparent difference between a #1 and a #2 rated institution rests with the interpretation of words like "actively" and "affirmative steps". No further amplification is provided to examiners, who are given considerable leeway to apply these criteria on their own to the institutions they

evaluate. For example, the agencies do not measure the percentage of assets invested for a particular CRA related credit need to determine performance levels. In effect, the agencies have punted their responsibility to set substantive standards to their examiners, who are left to make admittedly difficult judgments about CRA performance.

The lack of substantive standards contributes to the unevenness and inconsistencies one can find by reviewing exam reports. It also appears the agencies may be using different standards from one another. For example, in 1986, only one of the thrift institutions received a top rating from the FHLBB, while during the same year 648 banks received the top rating from the OCC, FDIC, and FRB. Thus, it would appear that an outstanding rating means one thing to FHLBB examiners and something different to commercial bank examiners.

The Application Review and CRA Protest Process Must Be Improved

CRA is unique among consumer protection laws in that it specifically directs the regulatory agencies to take an institution's record of compliance into account in determining whether or not to approve a pending expansion application. Perhaps this helps to account for why this aspect of CRA enforcement is misunderstood by lenders and so inadequately implemented by the regulatory agencies.

As we have seen, the examination process has not been an effective instrument for encouraging improvements in lending performance of financial institutions. The inadequacy of the examination process, therefore, places a greater burden on the regulatory sanction provided by CRA. Agency action on pending applications becomes an even more important element for assessing the commitment of the regulators to enforcing CRA, and it is watched carefully by the banking industry.

Unfortunately, the use of formal sanctions, either through denial of applications or conditional approvals, is so minimal that it poses little threat to an institution with even an admittedly weak CRA record. In the years since CRA became effective, more than 40,000 applications have been acted on by the four regulatory agencies combined, but only nine of them have been denied on CRA grounds. All of these denials, at least to our knowledge, involved branch applications. And the Federal Reserve Board has yet to deny its first application for CRA related issues.

The regulators maintain that they prefer to address CRA issues through means other than denials. But the number of applications in which CRA-related conditions were imposed or where an application was withdrawn by an institution with a CRA record are minimal.

Once again, the burden for enforcement has come to rest on the shoulders of community groups. In increasingly frequent

numbers, community groups have been submitting public comments on the CRA records of institutions with applications pending before the various agencies. Usually these comments indicate opposition to approval of the pending application until such time as the applicant makes commitments to improve its lending performance to low and moderate income and predominately minority areas. The use of the public comment process and the filing of these "CRA protests", or "CRA challenges" as they are called, have become an important means by which the agencies spot institutions with deficient CRA records.

The number of CRA challenges that have been filed with the regulators has been rising steadily since 1984. For example, the Federal Reserve Board, which acts on bank holding company applications as well as applications filed by state-chartered member banks, counted 35 CRA challenges filed last year, the most challenges ever filed. By contrast, in 1986 the FRB received 20 challenges; in 1985, the agency received 19; and in 1984, it only received 3 protests. Almost one-half of the 112 CRA protests that have been filed with the FRB since 1978 have occurred in the past two years alone. The other agencies report increases in CRA protest activity as well.

The unprecedented number of CRA challenges has sparked an outcry from certain segments of the banking industry. Recent press reports quote certain bankers as referring to efforts by community groups to use the public comment process as "extortion."

These charges may stem from the fact that many CRA protests result in negotiated settlements in which the community groups eventually agree to withdraw their complaint.

The charge that community groups are somehow distorting the public comment process is without merit. First, CRA protest activity, despite their increasing number, still represent only a tiny portion of application activity in any given year (under 1%). The CRA challenge process is usually used by community groups after previous attempts at communication with the institution have failed or if the institution is perceived as having a poor record. Mounting a challenge is a time consuming and resource draining activity for local grassroots organizations with little or no staff. For a community group to be effective, it must devote considerable energy to documenting its case against the institution. The agencies require CRA challenges to be supported by statistical research and analysis.

The willingness of community groups to negotiate settlements of CRA challenges rather than await a regulatory decision is attributable to two reasons. First, they know the regulators are extremely unlikely to deny an application regardless of the merits of the protest petition. Second, they know that their primary leverage comes from their ability to delay agency action on an application. Since they are primarily interested in obtaining substantive commitments from financial institutions to improve their lending records, the local groups use this limited

leverage to enter into negotiations with applicants. If they are able to successfully resolve their dispute they are quite willing to withdraw their protest and support the prompt approval of the pending application. Far from being extortionist, this negotiated settlement process has been the most effective means for encouraging improvement in the lending performance of many financial institutions.

Additionally, CRA protests often raise legitimate issues about the CRA performance of applicants. For example, the FRB found that of the 112 CRA protested application it has acted on, in 44 cases the protest was withdrawn, often after a settlement agreement was reached. Moreover, commitments for improvements in CRA performance were obtained in 28 (or 41 percent) of the remaining 68 applications that were protested. This suggests that CRA issues were involved in a majority of the applications that were protested by community groups. Meanwhile, the OCC and FDIC have acknowledged that CRA protests are useful to them in spotting applicants with deficient records. This has been especially true in recent years, as the frequency of CRA exams has declined.

Although the CRA protest process has led to some substantive improvements in the lending performance of certain institutions, local groups report that the agency procedures concerning applications are confusing and not well designed to maximize citizen intervention into the application process. Community

protestants also complain of the unfair and arbitrary manner in which the agencies process their complaints. Here are a few examples:

- o The New York Regional Office of the FDIC approved an application under delegated authority, even though officials in that office knew that a CRA protest would be submitted earlier that same day. Under FDIC procedures, CRA protested applications cannot be approved under delegated authority, but must be reviewed by the FDIC Board of Directors in Washington, D.C. Although the delegated approval of the application was eventually set aside after the local groups complained, it was apparent that FDIC officials were unaware of their own procedures on this matter.

- o The OCC's Atlanta Regional Office has acted in an arbitrary and inconsistent manner on requests for public hearings on CRA protested applications by national banks. In 1986, the Atlanta Regional Office approved a request by the Shelby County Community Reinvestment Committee for a public hearing on an application by a Memphis bank, First Tennessee Bank. Six months later, the same regional office denied a request for a hearing by Fairfield United Action (Columbia, S.C.) on an application by South Carolina National Bank. Approximately six months after that, the regional office denied a second request for a public hearing, this one by the Savannah Community Reinvestment Alliance (Savannah, GA) on an application by First Union Bank of Georgia. There was no

legitimate basis for distinguishing between the requests; all three met the standard set out in the OCC regulations.

o The biased and clearly arbitrary handling of a CRA protest pending before the Home Loan Bank of Cincinnati. The Shelby County Reinvestment Committee protested an application by Leader Federal Savings and Loan Association. The group has encountered numerous difficulties in obtaining information that is required under the Home Mortgage Disclosure Act. They have also encountered numerous examples of the District Bank's failure to follow FHLBB procedures regarding the handling of protested applications and the presentation of oral arguments.

#### Recommendations for Improvements in CRA Enforcement

Given the multitude of problems that currently exist with CRA enforcement we recommend four major approaches to reform and strengthen the existing process:

o Expanded agency enforcement -- more frequent on-site agency exams; a full-time, specialized CRA and consumer examiner force; separate units of consumer and community affairs with direct control over the compliance exams; exemption of the bank examination function from the Paperwork Reduction Act.

o Greater agency accountability and expanded public disclosure -- public disclosure of CRA evaluations and ratings; disclosure of commercial lending comparable to HMDA; more detailed reporting to Congress on the examination and protest process.

o Reform of the CRA rating system -- the current CRA rating system should be shifted to a comparative system to permit the measurement of a lender's CRA performance relative to comparably-sized institutions (\$1- excellent, \$2- good, \$3-average, \$4-limited effort, \$5- poor); CRA rating standards must be developed to permit examiners to distinguish between the different levels of performance; examiner contacts with individuals and organizations outside the institution should be required as a routine component of assessing an institution's CRA record.

o Reform the application review and CRA protest process -- improve the public notice procedures for pending applications; expand the public comment period to ensure ample opportunity to participate in the application process; develop more clearly defined standards for judging substantive protests and the need for public hearings on pending applications; agency orders on applications should discuss CRA issues, conclusions, and factual basis supporting conclusions; applications by poorly rated institutions should be denied; develop more clearly defined policies regarding CRA agreements and their role in future exams.

In addition to these proposals, we recommend that the Committee request the General Accounting Office to conduct a full-scale audit of the four agencies' CRA, civil rights, and consumer compliance programs.

#### Conclusion



There is a certain ebb and flow to agency enforcement in CRA and consumer compliance, but we believe it would be a mistake to anticipate substantial improvements in CRA enforcement without explicit statutory directives from Congress. Accordingly, we support CRA reform proposals that are embodied in H.R. 4022, the Community Benefits Banking Act of 1988, and H.R. 4026, the Consumer Banking Act of 1988.

H.R. 4022, which has been introduced by Rep. Joseph Kennedy features a number of the agency reforms and improvements in the CRA enforcement process that I have discussed in my testimony. The Kennedy bill would require each of the four federal financial regulatory agencies to establish a separate division of consumer and community affairs, which would have the responsibility of conducting CRA and consumer compliance exams. The division would have authority to make recommendations to the head of the agency on the disposition of pending applications. The bill also requires the agencies to disclose the CRA evaluations and ratings for each of the institutions it supervises. Lastly, it revamps the CRA rating system and limits authorization for bank holding companies to enter into non-banking activities and engage in interstate banking to those with superior CRA records.

The Schumer bill would expand the current loan disclosure requirements for financial institutions, by requiring them to report annually on the geographic location of their commercial lending activities, including loans to small businesses.

We hope that this Committee will consider these legislative proposals during the current session.

Mr. Chairman, that concludes my formal written testimony. I will be glad to answer any questions you or other members of the Committee may have.

Attachment 1

Mortgage Lending Studies

1. Pogge, Jean. Vistas of Opportunity: An Analysis of 1983 and 1984 Residential Lending in the Denver/Boulder SMSA. Woodstock Institute, 1987.
2. Woodstock Institute. Islands of Opportunity: Mortgage Banker Residential Lending Within the Chicago SMSA from 1980-1983, 1986.
3. Woodstock Institute. A Tale of Three Cities: The Distribution of Housing Credit from Regulated Financial Institutions in the Chicago SMSA from 1980-1983, 1986.
4. Woodstock Institute. Where the Money Flows: Lending Patterns in the Washington, DC-Maryland-Virginia SMSA, 1985.
5. Woodstock Institute. Where Do Lenders Lend?: Banks of Regulated Financial Institutions' Performance Within the Washington, DC-Maryland-Virginia SMSA in 1982, 1985.
6. Shlay, Anne. Credit on Color: The Impact of Segregation and Racial Transition on Housing Credit Flows in the Chicago SMSA from 1980-1983. Center for Metropolitan Planning and Research, the Johns Hopkins University, 1986.
7. Shlay, Anne. Not In That Neighborhood: The Effect of Population and Housing on the Distribution of Mortgage Finance within the Chicago SMSA from 1980-1983. Center for Metropolitan Planning and Research, the Johns Hopkins University, 1986.
8. Goldstein, Ira J. The Flow of Housing Capital in the Philadelphia Metropolitan Area, 1982-1984. Temple University, 1986.
9. Shlay, Anne. Maintaining the Divided City: Residential Lending Patterns in the Baltimore SMSA. Institute for Policy Studies, the Johns Hopkins University, 1987.
10. Shlay, Anne. The Underwriting of Community: Evaluating Federally Regulated Depository Financial Institutions' Residential Lending Performance Within the Baltimore SMSA from 1981-1984. Institute for Policy Studies, the Johns Hopkins University, 1987.
11. Shlay, Anne. Backyard Credit Flows: Census Tract Residential Lending Profiles Within the Baltimore SMSA from 1981-1984. Institute for Policy Studies, the Johns Hopkins University, 1987.

## MONEY &amp; BANKING

Business Week 3/2/87

## LEANING ON BANKS TO LEND TO THE POOR

Activists citing unfair practices are holding up mergers

**T**he wave of bank mergers is a boon to some unlikely constituencies. Take Eddie and Sandra DuBois. Because of a \$200 credit card dispute and Sandra's brief employment history, they were turned down for a \$15,500 mortgage. But all was not lost. Philadelphia's Fidelity Bank offered the couple a low-interest, \$10,800 loan that enabled them to buy a different house. Aggressiveness? Altruism? Hardly. An array of 37 community groups and churches had threatened to block Fidelity's acquisition of another local bank until Fidelity started a new, low-income lending program.

Across the country, activists have seized on bank mergers to extract special lending commitments from banks they claim are "red-lining": discriminating against certain ethnic groups and poor communities. In the past year, says Allen J. Fishbein, an attorney for Washington's Center for Community Change, bank regulators have reviewed about 40 merger protests, which will result in an estimated \$300 million in lending to the poor.

**'MORE TEETH.'** Last summer, for instance, Crocker National Corp. agreed to start a \$41 million program after community groups tried to block its acquisition by Wells Fargo & Co. And in August, Midlantic Banks Inc. in Edison, N.J., agreed to a lending program estimated by activists at as much as \$50 million after a group tried to block its merger with Philadelphia's Continental Bank.

To achieve these ends, activists have relied on the Community Reinvestment Act (CRA), a 1977 federal law that requires federally chartered banks and thrifts to lend within areas where their depositors live. The law was designed to fight discriminatory lending practices within poor or ethnic neighborhoods.

The CRA, along with the companion Home Mortgage Disclosure Act, requires banks and thrifts to disclose their mortgage lending by census tract. That gives community groups data they can use to challenge bank lending patterns. But the real leverage came only after the Supreme Court gave the go-ahead to regional bank mergers in mid-1985. Then, activist groups had a flood of in-

terstate merger applications they could hold hostage. "The advent of interstate banking has given the CRA more teeth," says Michael Shea, a New Orleans director for the Association of Community Organizations for Reform Now.

In Baltimore, for example, a coalition that included the local AFL-CIO and NAACP chapters recently won a five-year, \$50 million commitment from Maryland National Corp. That program was created after Maryland National announced plans to enter the lucrative Washington (D.C.) market by acquiring American

Community groups' actions are 'extremely costly to the industry,' says a bankers' spokesman. 'It's blackmail'

Security Corp. Maryland National's offer includes \$50,000 annually for credit-counseling services and a promise to improve recruitment from community and minority schools.

Regulators haven't prohibited a bank merger solely because of public protest, but banks find that fighting off community groups can be taxing. When New Orleans-based Hibernia Corp. found itself under pressure from a local group, it dug in for the fight. "We have an excellent CRA record," says Robert G. Courty, Hibernia's general counsel. "They made demands that were outrageous." The protest delayed the bank's acquisition of Southwest Bancshares by seven months.

Outcomes like that frustrate many bankers, who insist that the industry is living up to its public responsibilities. "It's costly to the industry, and in a lot of ways it's blackmail," says Kirk Willison, spokesman for the American Bankers Assn. Nevertheless, activists are convinced that this tool is one of the few effective ways to extract more lending for the poor. Wherever there are two banks planning to merge, protesters are increasingly likely to be found nearby.

By Dean Foust in Atlanta

## STATE OF THE STATES

Neal R. Peirce

### Neighborhood Challenges to Big Bank Mergers

PHILADELPHIA—The Constitution's 200th anniversary is capturing the headlines here this summer, but some of the most interesting action is unfolding in the city's neighborhoods.

Millions of dollars of new bank credit are flowing into troubled areas because a band of community activists is applying the federal 1977 Community Reinvestment Act with gusto.

The merger and acquisition mania of banks across the country has triggered a spectacular increase of threat and actual suit under that law, which requires that banks prove that they serve the credit needs of poor, as well as affluent, neighborhoods in their areas before they can merge.

When the big Fidelity Bank N.A. moved to acquire a smaller local bank, 37 community groups and churches protested past lending practices in poor neighborhoods and got agreements for a new targeted lending program with an estimated value of \$60 million.

Pittsburgh's big Equibank, moving into Philadelphia, was "persuaded" that it made sense to locate a branch in Strawberry Square Mall, in the midst of North Philadelphia's massive ghetto.

The Philadelphia activists went across state lines to win an \$85 million low-income neighborhood reinvestment package from New Jersey's Midlantic Banks Inc., which was trying to acquire Pennsylvania-based Continental Bankcorp Inc. The activists could prove that Midlantic had made scarcely any loans in Camden, Newark, Passaic and Paterson—cities in which it had 19 branches and \$470 million in deposits.

After the protest coalition treated Midlantic bankers to a "power lunch" at a North Camden soup kitchen, the bank offered concessions—but not enough. So the Philadelphians, joined by New Jersey community groups, set up picket lines at multiple Midlantic locations. The bank finally agreed to a broad package of financial concessions for low-income neighborhoods. Among them: below-market interest rates on home mortgages, acceptance of sweat equity in lieu of cash down payments and cost-free "lifeline" checking accounts.

Philadelphia currently is a hotbed of bank challenges. But confrontations have been instigated as well in Chicago (a seedbed of the movement), Atlanta, Baltimore, Los Angeles, St. Louis and nearly 120 other cities in 39 states.

Gale Cincotta, the community organizer who led the initial charge to get the Community Reinvestment Act passed, paved the way to big breakthroughs by getting a \$173 million package of concessions from merging Chicago banks in 1984.

In 1985, the Supreme Court approved regional bank mergers. Community Reinvestment Act challenges and protests mushroomed, from 3 in 1984 to 19 in 1985 and almost 40 last year. In two years, 13 of the 25 largest bank holding companies have been challenged.

Add up all the banking concessions to the nation's poorer

communities, and the total comes to \$5 billion, according to Allen J. Fishbein of the Washington-based Center for Community Change. In many ways, that's arguably more beneficial for depressed towns and neighborhoods than years of federal antipoverty assistance.

The new cases are proving that banks made a critical error in judgment when they decided to red-line (mark as off-limits) large, impoverished city areas where home owners and stores needed loans. Today, under some agreements with banks, poor people, who often don't use credit cards, are getting credit for, say, having made regular rent payments. Banks are even committing to changes in their own hiring

practices and charitable giving to better reflect neighborhood needs. There's sometimes a problem in finding enough creditworthy applicants to use the loans the banks make. But loans that are being made are producing fewer losses than bankers expected.

The Federal Reserve System, regulator of the big bank holding companies, is often criticized by neighborhood activists for not denying mergers when they are challenged. But the Fed takes its time sifting through any and all challenges to a proposed merger. That has proved to be a powerful incentive to banks to invest in low-income communities; the alternative

could be to lose immense profits through delay. At the Federal Reserve Bank of Philadelphia, community affairs officer Frederick M. Manning works hard to encourage banks and poor communities to talk and then agree. He recently induced major bankers to sit down at the Fed with some of the feistiest groups challenging mergers. Among them were Philadelphia's Community Development Coalition Inc., the Rev. Joseph Kakalec and his neighborhood network and the Association of Community Organizations for Reform Now (ACORN). "It was done on a very friendly basis—instead of at throat level," Manning said.

ACORN's agents are so adversarial that they have been called the Trotskyites of neighborhood protest in America. They challenged more than 30 bank mergers nationwide in 1986 alone. "ACORN has passed Gale Cincotta in instilling fear in banking circles," Manning said.

Why in the world, one has to ask, would the well-lobbied, influential American banking community put itself at the mercy of scrappy neighborhood organizers?

One answer is that many recognize that the community challenges are meritorious—and that the banks have no great defense. Another is that the bankers have bigger fish to fry. They are preoccupied with the rich opportunities of deregulation: local mergers, interstate banking and future targets such as selling stocks or taking equity positions in real estate.

It may be true that the Community Reinvestment Act and community organizers provide a sharp jab to the financiers' rear. But not enough pain to risk a battle in Congress, where Cincotta and her allies proved that neighborhood folks are themselves no slouches at lobbying. □

Bank concessions to poor neighborhoods are arguably of more benefit to depressed towns than years of federal antipoverty assistance.

The CHAIRMAN. I want to thank all of you for your very fine statements.

Miss Revere, bankers say they don't make loans in certain areas because there's no demand. Community groups say the problem is on the supply side.

What do you think the major obstacles are in getting supply to equal demand? Do you think that there are obstacles involved the way business is done by realtors, by lenders, by mortgage insurers, by secondary market brokers? Where is the principal problem?

#### PRINCIPAL PROBLEM

Miss REVERE. Well, I think there is a problem in each of those areas. We have found—and this probably relates to your earlier question to the previous panel—that the bankers we've worked with, negotiated with, find that they can make loans to the kinds of neighborhoods we're concerned about, the formerly disinvested neighborhoods, and derive a reasonable profit from those loans. So partly it's an educational process with bankers.

Partly, we found that marketing does not occur with the same intensity in inner cities, central city communities as it does in suburban areas, that marketing resources by the financial institutions are allocated according to where they believe the greatest profit and lowest risk will be and that that is not in the central city.

There are certainly problems with the secondary market right now and there are problems with the mortgage insurers.

So I would say that we need to work on all of them, but as banks get more experience actually doing community reinvestment, as required by the CRA, we do find that they often become converts to community lending and that helps a great deal.

The CHAIRMAN. That's very encouraging. I hope we can do more to convince bankers that they're just passing up profitable opportunities here. I think that would be the most useful thing we could do.

Mr. Bradford, some observers say that the inaction of the regulatory agencies is forcing community groups to carry the burden for enforcing CRA. They say that if the agencies did their jobs, community groups would not be forced to bring so many protests, would not be forced into so many confrontations with lending institutions.

What do you think?

Mr. BRADFORD. Well, I think that's absolutely true.

The CHAIRMAN. How do we get them to do their job? What can we do?

Mr. BRADFORD. I say this not wholly facetiously. Holding hearings seems to be very effective. I've gotten several calls in the last 2 months by regulatory agencies. The Federal Home Loan Bank Board in Des Moines suddenly wants to have a community reinvestment officer that they haven't had for 5 years, and they said, "Well, Washington told them to do it."

We got a call from an examiner from the Comptroller of the Currency who suddenly was going to examine the five largest banks in Minnesota this last month and they hadn't done that for a long time. And when she was pressed about why she was doing it, she said, "Well, orders came from Washington." What she finally said



was, which was a surprise to us, that Congress has a division of banks and they can tell the Comptroller what to do. I presume she was referring to this committee.

The CHAIRMAN. I wish that was true.

Mr. BRADFORD. So it really isn't facetious to say that. There's a lot of activity out there when someone thinks they're going to be held accountable. I think making the ratings public would help. I think ensuring a right to hearings by community groups would help.

The banks aren't afraid of the regulators. They are afraid of their record becoming public and when the regulators make it almost impossible to have a public hearing, they do a tremendous disservice to one of the few levers that the community people have.

The CHAIRMAN. When you make it public and they're all A's and B's, what salutary effect does that have?

Mr. BRADFORD. I think it brings it out into the open and the regulators have to defend those ratings and I think that's one of the things they don't want to do because, as Allen says, they haven't got a good basis for making those decisions.

The CHAIRMAN. Can you give us any reason why the ratings should not be made public? Is there any justification at all?

Mr. BRADFORD. No. Their justification that they have to maintain these wonderful relationships with the lenders is kind of a silly notion. I don't think it's going to cause a run on a bank, particularly considering the kinds of information that they're required to disclose now about their loan losses. It's just, I think, that they're embarrassed about their own ratings and about their inability to defend them.

It seems like the disclosure of the ratings wouldn't be a very powerful tool, but if you look at the Home Mortgage Disclosure Act and I think what commercial lending disclosure would do, if you allow people to see what the lenders are doing and what the regulators are doing, it turns out to be a very powerful force in reinvestment. The public pressure is very strong.

The CHAIRMAN. Mr. Fishbein, you were a member of the Federal Reserve Board's Consumer Advisory Council, is that correct?

Mr. FISHBEIN. Yes.

The CHAIRMAN. I'd like your views about the Council's work and its recommendations.

Mr. FISHBEIN. Well, back in 1983, really as a result of criticism that Chairman Volcker had received about his agency's enforcement of CRA by Gale Cincotta and National People's Action, the Chairman went to the Consumer Advisory Council and asked them to do a 10-month study on his agency's enforcement of the act.

It happened in a very interesting way. Apparently he went to his staff and said, "Are we really worse than everybody else?" And his staff said, "Well, we can do an evaluation for you." And the way I heard the story is that Chairman Volcker said, "Well, that would be a little like the fox guarding the chicken coop." So instead he went to the Consumer Advisory Council, which consists of consumers and lenders representatives. The study that we came up—and I served on that committee that did that study—we came up with 50 recommendations for regulatory improvement. The essential rec-

ommendation was that CRA needed a higher priority within the Federal Reserve System.

I guess the most surprising thing I found about that effort was that for enforcement purposes there really isn't one Federal Reserve Board. There are 12 Federal Reserve Banks. They have their own enforcement practices and they vary. A Reserve Bank in one part of the country may barely be acknowledging the existence of CRA whereas a Reserve Bank in another part of the country might be doing an adequate job, and even that will vary from time to time.

The CHAIRMAN. Was the Consumer Advisory Council able to get any improvement, do you think, in the Federal Reserve Board's overall operation?

Mr. FISHBEIN. As I understand it—I'm no longer on the Council—there have been some modest follow-through on the recommendations. However, I think the key recommendation regarding setting up an adequate data collection system to detect mortgage lending discrimination and changing the CRA rating system has never been undertaken by the Federal Reserve.

The CHAIRMAN. Have the other regulators done anything like this at all? Do they have a Consumer Advisory Council, too, to your knowledge?

Mr. FISHBEIN. No, they don't, and they have avoided evaluation like the plague. I guess the last time there was a full-fledged evaluation was back in 1980 when the U.S. General Accounting Office did an evaluation of consumer, CRA, and Civil Rights compliance and found that there were wholesale inconsistencies and weakness in the overall enforcement process.

The CHAIRMAN. Do you think it would be constructive and practical to have consumer advisory councils for each of the regulators?

Mr. FISHBEIN. Yes, I do, and I think it would be more helpful if these advisory councils were at the local, regional or district bank level and that they had the responsibility to advise the agencies on procedures to use for enforcement.

The CHAIRMAN. And how should they be appointed?

Mr. FISHBEIN. They could be appointed through the regulatory system and I think—

The CHAIRMAN. Again, isn't that a matter of asking the fox if not to guard the chicken coop to pick another fox to do it for him?

Mr. FISHBEIN. Well, that is always a danger with advisory committees, but I think if it is mandated that membership will consist of certain types of organizations represented on that advisory council, it can serve some useful purposes.

#### AGREEMENT BETWEEN COMMUNITY GROUPS AND LENDERS

The CHAIRMAN. Miss Revere, a new paper on neighborhood lending agreements from the Lincoln Institute said that CRA has played a major role in developing a negotiated development agreement between community groups and lenders. It says that these agreements could become the model for community reinvestment plans around the country. Do you agree?

Miss REVERE. I agree that neighborhood lending agreements have been very useful and continue to be very useful and provide a tre-

mendous amount of very valuable financing—valuable because in each case it's directed toward particular local needs—and I'm sure you're well aware of the Chicago agreements where we've dealt with problems like the mixed use buildings and multifamily housing, whereas other types of lending are more crucial in other parts of the country.

Each of those agreements has to come through an enormous amount of work and resources being put in by community groups who are those in the whole neighborhood development scene who have the least amount of resources to spend. They also can only be triggered by an application to the Federal regulators. There have been a lot of these applications in recent years because of the pace of merger and acquisition activity.

As we saw in the video that started off the hearing, we haven't always had the current pace of CRA agreements and I expect that some time in the future that will start to decline again as the amount of applications decreases as well. So while I think that the CRA agreements are a very valuable model, and they deserve to be replicated all over the country, I don't think that they're enough and I think that our studies and other people's studies of disinvestment show that you can't pick off the banks one by one and have each of them contribute adequately to community reinvestment at the same time.

The CHAIRMAN. Mr. Bradford, how would you respond to lenders who say they don't think it is prudent for them to deal in higher risk lower profit inner city loans?

Mr. BRADFORD. Well, I don't think most of those lenders can produce anything to show particularly that they are higher risk than other types of lending they engage in. I was just talking to a reporter from the Constitution/Journal in Atlanta who's doing a study down there. He indicated that the lender with the best record of lending in the inner city also, when you look at their performance report, has the lowest loss rate.

The CHAIRMAN. Is that right? Who is that lender? That would be something to be proud of.

Mr. BRADFORD. Citizens Trust Bank in Atlanta.

The CHAIRMAN. Citizens Trust Bank. Let's give them an award.

Mr. BRADFORD. There are a lot of development banks around. I have found in interviewing banks that there are a lot of banks who believe that they are the economic engine of their community and take that seriously and reinvest. We need to profile those lenders and we need to locate them more often. It's just generally not the case.

Most of the community groups in these reinvestment agreements that we've been talking about, when there is a genuine risk that's exceptional to the market, the groups have been very conscientious about developing a public subsidy program or a guarantee program to take that risk away from the banker. The community groups in their reinvestment agreements do not want the bankers to get into trouble. They want their community developed and they want it done in a sound way. So what you see over and over again—that's one reason the program has become so complex—is that those people are trying to build the capacity in the businesses, in the development organizations to make sure those loans go out and that

they're sound and to build the proper public resources and other types of programs that are needed to make sure those loans are sound.

The CHAIRMAN. Thank you very, very much. You folks have done an excellent job. We're in your debt.

Our final panel is a group of people who speak for the bankers. Jack Kolesar, president and chief executive officer of the AmeriTrust Development Bank; and Richard Hartnack, senior vice president of the First National Bank of Chicago.

#### STATEMENT OF JOHN M. KOLESAR, PRESIDENT, AMERITRUST DEVELOPMENT BANK

Mr. KOLESAR. Thank you, Mr. Chairman. I appreciate the opportunity that the committee has afforded me to testify today concerning the Community Reinvestment Act.

My name is Jack Kolesar and although I'm here today principally in my role as president and CEO of AmeriTrust Development Bank in Cleveland, OH, I occasionally wear two other hats that I think are pertinent to the subject of the hearings. I serve as chairman of a special task force of the Consumer Bankers Association dealing with consumer banking issues and I also have the honor of serving the Board of Governors of the Federal Reserve System as a member of their Consumer Advisory Council currently.

While my written testimony that I've submitted in advance addresses each of the questions submitted to me by the staff, I thought I could make the most productive use of this time today by addressing three key points.

The first is the positive experience that the Development Bank has had with CRA lending. The second is our experience with Federal regulators on CRA enforcement. The third is my suggestions on refinements to the act itself.

#### THE AMERITRUST EXPERIENCE

AmeriTrust Development Bank is a State-chartered subsidiary of the AmeriTrust Corp. devoted exclusively to providing financial services for economic and community development efforts throughout greater Cleveland, with a particular emphasis on Cleveland's low and moderate income neighborhoods. Unlike a bank community development corporation, we are a full service commercial bank. We accept demand deposits and we make commercial loans.

We are the beginnings I think of that development banking industry that Mr. Bradford referenced in his comments.

We are unique within the industry, however, due to our market niche. Sometimes referred to as the Robin Hood Bank, we draw deposits from the largest corporations and institutions in Cleveland and we then lend those funds for housing and commercial development in Cleveland's neighborhoods.

The bank had its origins in a small department within our lead bank, AmeriTrust Co. back in 1983. Called the Development Finance Unit, it consisted simply of two individuals who engaged in three fairly simple activities in an effort to carry out the bank's responsibility to invest in low and moderate income neighborhoods. We called on neighborhood development organizations to deter-



mine their credit needs. We helped them shape their requests into conventional loan packages, and then we served as advocates throughout the credit review process inside the bank.

After only a few months experience with that department, we learned some very important and, admittedly, surprising lessons. We learned that it was not necessary to dilute the bank's credit standards in order to approve those loans. Neither was it necessary to give away the bank with below market pricing in order to make them financially feasible. Third, we discovered that the market for credit in those areas was much greater than we had anticipated.

That unexpected volume compelled us then to consider an expansion of this two-person operation. But in the course of our planning that expansion, it occurred to us that if we spun this off as an autonomous subsidiary bank, rather than simply expanding the existing function, it might be possible to attract deposits to fund those loans more easily than we could as a department within the existing bank.

So based on that admittedly tenuous assumption, we opened our doors as AmeriTrust Development Bank on April 23, 1986, armed with a staff of five, a charter from the Ohio Superintendent of Banks, and \$3.9 million of initial capital from our holding company.

Our experience during the ensuing 2 years has exceeded our highest expectation. The pro formas prepared for our charter application projected that both deposits and loans would grow by \$5 million during each of the first 2 years, and that we would operate at a deficit for the first 5 years of business. Our deposit projections were virtually right on target. At the end of our second year of business, we have \$11 million on deposit. However, we have invested in excess of \$20 million loans, which is 90 percent over the planned volume. And the sweetest part of all is that we had a net operating profit of \$146,000 at the end of 1987. To keep pace with that demand, we have increased our staff now to 9 and we will be adding 2 more people during the course of this year.

Admittedly, our profit margin is relatively thin by industry standards. At the present time we are performing at approximately a 5-percent return on equity and a .85 percent return on assets, compared to the industry targets of 15 percent and 1 percent respectively.

As encouraging as those numbers are, profitability should not and in our case is not the primary consideration. Of greater importance is the issue of credit quality. And here again, our experience has been extremely positive. We do four types of lending at the Development Bank: residential real estate, home improvement loans to individual, commercial real estate, and commercial loans to small business.

A recent internal audit of the bank compared our delinquency rates in each of these loan categories to the corresponding portfolios in our lead bank, a bank which enjoys a reputation for the highest credit standards amongst peer regional banks. The auditors found that the performances of our residential real estate and small business loan portfolios were actually better than those of our lead bank.



Of almost equal importance where areas is the question of the pricing aware most of the agreements concerning CRA protests include provisions for the lending side. I object to that practice on practical grounds. First of all, one does not believe that we do anyone any favors by making economically viable when in fact it is of greater importance, is my conviction of tough love—that concession is in the long run. The entire purpose should be to bring low and moderate into the economic mainstream. That goes against artificial pricing which tends to aggravating subsidized housing and community areas. Nonetheless, we certainly do need a nudge in order to make the end of a two-tiered pricing practice where a profit organization is the borrower. We need to raise rates by at least 50 basis points in order to give them the nudge that they often need. Other than that, basis.

In my written testimony, I relate what I have had with all three of the Federal Reserve Banks concerning CRA enforcement and then go on to talk about for improvements to the Community Development Fund. I would be happy to respond to any questions you have. What I haven't had time to say.

[The complete prepared statement follows.]

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Testimony of John M. Kolesar, President  
Ameritrust Development Bank  
On the Community Reinvestment Act  
Before the Committee  
on Banking, Housing and Urban Affairs  
United States Senate

March 22, 1988

Mr. Chairman, members of the Committee, good morning.

My name is Jack Kolesar. Although I am here today in my capacity as President and Chief Executive Officer of Ameritrust Development Bank in Cleveland, Ohio, I occasionally wear two other hats which are pertinent to the subject of these hearings. I serve as chairman of a special task force of the Consumer Bankers Association on consumer issues, and I have the honor of advising the Board of Governors of the Federal Reserve System as a member of their Consumer Advisory Council.

I am, therefore, especially appreciative of the opportunity to testify before this Committee concerning the effectiveness of the Community Reinvestment Act (CRA), private sector initiatives to comply with its prescriptions and potential refinements of CRA.

THE POSITIVE EXPERIENCE OF AMERITRUST DEVELOPMENT BANK

Ameritrust Development Bank (ADB) is a state-chartered subsidiary of the Ameritrust Corporation, devoted exclusively to providing financial services for economic and community development efforts throughout greater Cleveland, with a particular emphasis on Cleveland's low and moderate income

neighborhoods. Unlike a bank community development corporation, we are a full service commercial bank. We accept demand deposits and we make commercial loans.

We are unique within the industry, however, due to our market niche. Sometimes referred to as the Mobis Hood Bank, we draw deposits from the largest corporations and institutions in Cleveland and lend those funds for housing and commercial development in Cleveland's neighborhoods.

The bank had its origins in a small department called the Development Finance Unit within our lead bank - AmeriTrust Company, N.A. - back in 1983. In an effort to carry out the bank's responsibility to invest in low and moderate income communities, this unit consisted of two individuals who engaged in three fairly simple activities:

1. Calling on neighborhood development organizations to determine their credit needs;
2. Helping these organizations shape their requests into conventional loan packages; and
3. Serving as advocates for these loan requests throughout the loan review process within our bank.

After only a few months' experience we learned some very important - and admittedly surprising - lessons. We learned that it was not necessary to dilute the bank's credit standards in order to approve these loans. Neither was it necessary to engage in below market pricing in order to make them financially feasible. And we discovered that the market for credit in these areas was much greater than we had anticipated.

The unexpected volume compelled us to consider an expansion of the department. But in the course of our planning it occurred to us that if we spun it off into an autonomous subsidiary bank, it might be possible to attract deposits to fund these loans.

Based on that admittedly tenuous assumption, we opened our doors as AmeriTrust Development Bank on April 23, 1986 - armed with a staff of 5, a charter from the Ohio Superintendent of Banks, and \$3.9 million of initial capital from our holding company.

Our experience during the ensuing two years has exceeded our highest expectations. The pro-formas prepared for our charter application projected that both deposits and loans would grow by \$5 million during the first two years, and that we would operate at a deficit for the first five years of operation. Our deposit projections were right on target. We

have \$11 million on deposit at the end of our second year. However, we have invested over \$20 million in loans, which is 90% over plan. And the sweetest part of all is that we had a net operating profit of \$146,000 at the end of 1987. To keep pace with that demand, we have increased our staff to nine and we plan to add two more people this year.

Admittedly, our profit margin is relatively thin by industry standards. At the present time we are performing at approximating a 5% return on equity and a .85% return on assets, compared to the industry targets of 10% and 1%, respectively.

As encouraging as those numbers are, profitability has not been the primary consideration. Of greater importance to us is the issue of credit quality. And here again, our experience has been extremely positive. We do four types of lending at AmeriTrust Development Bank:

1. Residential real estate loans to individuals;
2. Home improvement loans to individuals;
3. Commercial real estate loans; and
4. Commercial loans to small business.

A recent internal audit of AD&B compared our delinquency rates in each of these loan categories to the corresponding portfolios in our lead bank, which enjoys a reputation among regional banks for credit standards of the highest quality. The auditors found that our delinquency rates for residential real estate and small business loans were actually lower than those of our affiliate.

An important issue when lending in low and moderate income areas is the question of loan pricing. It is commonly assumed that such loans must be priced significantly below market, as evidenced by the fact that most of the negotiated agreements coming out of the recent tidal wave of CRA protests include concessions to make loans at substantially reduced rates. While I understand the desire for bargain rates, I object to the practice on both theoretical and practical grounds. First, to substantially reduce an interest rate below market levels is to inject a degree of artificiality into the economics of a project and I don't believe that we do anyone any favors by pretending that something is economically viable when in fact it is not. Second - and of greater importance - is my conviction that concessionary pricing is counter-productive in the long run. The entire purpose of community reinvestment should be to bring low and moderate income communities back into the economic mainstream. That goal is ill-served by artificial pricing, which tends to aggravate



urban blight by concentrating subsidized housing and commercial ventures in low income areas.

By the same token, we recognize that some very worthwhile projects may need a nudge here and there to make them work. In recognition of this need, our policy has been to reduce our market price by 50 basis points when the borrower is a non-profit neighborhood development organization. We regard this to be a perfectly legitimate and justifiable exercise of commercial reason in that banks have always been willing to modify their rates for their best customers. For AmeriTrust Development Bank, these neighborhood organizations are our best customers and so we are simply perpetuating a long-standing and sensible business practice. Beyond that, we are also prepared to offer the same modest discount on a case-by-case basis for other projects which are likely to have a major impact on jobs or housing.

#### SELF-ASSESSMENTS

In light of the foregoing, I believe AmeriTrust Development Bank evidences an exceptional CRA track record. But this is a largely subjective assessment that must be rendered in more objective terms.

In measuring our own CRA performance, we have established two interrelated objective benchmarks - one relative and the other absolute.

There are two components to our relative measure of progress in residential real estate lending in low and moderate income areas. The first is a comparison of our residential real estate and home improvement loan portfolio with those of other commercial banks and thrifts in Cleveland. We use the annual Home Mortgage Disclosure Act reports for this purpose.

The other relative measure is our share of the total first mortgage market in the City of Cleveland. The College of Urban Affairs of Cleveland State University conducts an annual analysis of all title transfer data on record at the County Recorder's office. They then produce a report of all first mortgages by lender and by census tract. We have found this to be far more accurate and reliable data than the Home Mortgage Disclosure Act reports, for two reasons:

1. the census tract identification is more accurate; and
2. title transfer data includes activity on the part of unregulated mortgage lenders.

The disparity between these two sources of loan data highlights a significant flaw in the Home Mortgage Disclosure Act itself which the Committee may wish to address at some point.

Based in part on these relative assessments, as well as general money market conditions and longer term economic projections, we establish an absolute assessment factor in the form of specific annual targets for net new loans to be made in low and moderate income areas of greater Cleveland. We began this process in mid-1986. At that time, our total "CRA portfolio" was \$18.7 million. We set a target of \$5 million in new loans for the balance of 1986; by year end we had made \$17 million. At the beginning of 1987, total outstandings were \$22.6 million. Our target for the year was \$8 million, and by year end we had made \$10.9 million. At year end 1987, total outstandings were \$31.2 million. Based on our experience and projections, we have set our target for 1988 at \$9 million in new loans.

Based on this steady and successful track record, we believe that we have clearly targeted existing community needs and opportunities and have moved to address them to the benefit of the greater Cleveland community.

#### THE ROLE OF COMMUNITY ORGANIZATIONS

There is no question but that community organizations play a significant role in the CRA framework. In Cleveland, the network of community organizations consists of two distinct types of organizations. One is the neighborhood development corporation and the other is consumer advocacy groups. While their membership often overlaps, they have two very distinct missions.

Our experience has been that development organizations have been particularly helpful to us. They are essential partners of the bank in fulfilling our mission to invest in low and moderate income areas. The nature of this partnership varies from one project to the next, but their involvement is always critical. Often they are the actual borrowers seeking to finance a major housing or commercial development in their neighborhood. More often, they serve as a broker between the bank and a private developer. They serve as a valuable referral source for individuals who need a loan to buy and/or rehabilitate a home. When a proposal comes to us directly, we always make an effort to determine the local development organization's assessment concerning the proposal, in deference to their very real expertise on what makes sense for their neighborhood.

The role of advocacy organizations is less clear, but significant nonetheless. To the extent that they enjoy a broad base of support throughout a given neighborhood, they can be an effective resource for the bank in determining local credit needs. In the absence of a local development organization, the advocacy group can serve as the consultant or broker on a project. And there is no question that they have proven extremely effective in gaining the attention of banks whose commitment to local markets is questionable.

There are two situations, however, when the involvement of advocacy organizations is less than productive. The first is when they attempt to undertake a development project themselves. These efforts require a high degree of competence and experience in such technical matters as design, construction, management, and finance. Almost by definition, an advocacy group does not have the necessary capacity to carry this out successfully.

The second area of concern has to do with an advocacy group's use of the protest mechanism. As mentioned above, when the bank involved has made no demonstrable effort to comply with the intent of the CRA, a protest is a very effective way to remind them of their responsibilities. However, when the applicant bank has made a conscientious and demonstrable effort to carry out its responsibilities, albeit short of the ideal, the use of a protest as a first resort can have a

devastating effect. In the short term it can preclude - or significantly delay - the consummation of an important transaction, with the attendant financial impact accruing to such delays. In the longer term - and of more devastating consequence - is its chilling effect on a bank's institutional commitment to more than minimal compliance with the letter of the law. Worst of all, it discourages others from taking a more proactive approach, for fear that no matter how much they do, it will never be enough.

Rather than conclude on such a negative note, let me reiterate that neighborhood development organizations of all types are extremely productive partners in whatever success Ameritrust Development Bank has achieved.

#### POSSIBLE CRA REFINEMENTS

In response to your concerns regarding the role of the regulators in CRA enforcement, let me first say I have had broad first hand experience in this regard. Over the past six years I have had the pleasure of having three different agencies as my principal regulator. When Ameritrust Company was a state member bank, our principal regulator was the Federal Reserve. When the bank changed to a national charter, we came under the Comptroller. Ameritrust Development Bank, though, is a state non-member bank, regulated by the FDIC.

Initially I observed significant differences in the examination process between the three, with the Fed being, far and away, the most rigorous. I hasten to add, however, that over the past two years I have seen that disparity narrow significantly. If I were to make one suggestion to improve regulatory enforcement, it would be for increased training for examiners on the realities of community lending. If an examination is to be effective, it must go beyond questions of where the CRA file is kept and whether the lines on your map are drawn correctly. It must look at the hard, cold fact of how much the bank has invested in low and moderate income areas. In the end, that is what CRA is all about.

But this suggestion anticipates other possible refinements which could enhance regulatory enforcement of CRA, including mandatory interagency uniformity with respect to data gathering and reporting requirements and examination and grading standards. I would note that these issues have come into focus in recent weeks on the House side. In my view, such uniformity constitutes a necessary precursor to any enhancement of CRA requirements.

Regulatory studies to assess community credit needs would be a useful refinement. These studies could lay the foundation for creation through formal rulemaking procedures of objective CRA assessment criteria for institutions in each district. It is important to stress the distinction between

objectivity and uniformity in terms of CRA assessment standards because - as these studies would inevitably show - what is needed in Detroit is not what's vital to Des Moines; what works in Tucson won't necessarily fly in Tallahassee.

I stress this distinction between objective as opposed to uniform assessment criteria because it is a point missed by some of the aforementioned House initiatives. Whatever the need for CRA refinements, federal law must not become an allocator of private sector credit or financial services. Nor should it usurp the rights and responsibilities of a financial institution to define their own marketplace. Uniform assessment criteria, whether in the guise of "peer group" analyses or mandatory basic banking or check cashing services, are the red herrings of an agenda that far exceeds the objectives of CRA. They should not be permitted to confuse or misdirect the CRA debate.

On a related note, an equally distracting suggestion offered in recent weeks is the injection of the CRA protest mechanism in the section 4(c) application process for non-banking activity under the Bank Holding Company Act. As the foregoing sentence makes plain, this is an oxymoron in that the holding company's non-banking activities have little or no relationship to the bank affiliate's CRA performance. Non-bank subsidiaries and affiliates do not collect deposits, are not protected by federal deposit insurance, do not have

the privilege of borrowing at the discount window, and are not obligated to meet the credit needs of the communities in which their bank affiliates are located. They are primarily institutional service providers which seldom deal directly with the consuming public, and often are not situated in the affiliate bank's community.

The notion of trading new non-bank powers for enhanced CRA performance by banks provide a plausible public policy rationale for amending CRA. It would be otherwise, perhaps, if new powers and opportunities were to be offered to banks themselves, thereby improving their ability to serve their communities. But with limited exceptions, this is precisely not the direction the new powers debate is headed in its preoccupation with firewalls, cross-selling restrictions and interlock limitations. As such, this "carrot and stick" approach does little to enhance the ability of, or incentives for, a bank to better serve the needs of its community.

A more appropriate place for a "carrot and stick" approach would be to enhance positive performance incentives in existing law - specifically, at the point where a bank holding company has applied for approval of an acquisition or merger. I would suggest that if the applicant has in place a tangible and effective vehicle for lending in low and moderate income areas - such as a development bank, a community development corporation, or our precursor development finance department -

then I think the law should allow the regulator to assume that the applicant has made a conscientious effort to meet the credit needs of its banking communities. Then, if that application is protested on CRA grounds, the application should be permitted to proceed on its merits, with the assurance that the protest be resolved within some reasonable time after the application has been either approved or denied. I realize that this raises a number of questions about the degree of leverage afforded community groups under the existing system which must be worked out. As a conceptual approach, however, it would go a long way toward resolving the very legitimate concern within the industry that oftentimes one's very best effort isn't enough. At the same time, it assures community groups and other interested parties that any legitimate grievance will be addressed. This approach, coupled with an improved examination and assessment process, ought to result in a more effective law.

In a similar vein, sufficient public involvement in helping to enhance the CRA assessment criteria and monitoring the rating process would reduce the need for same in the application process. In short, if the grading system and assessment process are reformed satisfactorily, what is the continuing public policy justification for costly interventions and delays in the application process?



The CHAIRMAN. Mr. Hartnack, go ahead.

**STATEMENT OF RICHARD C. HARTNACK, SENIOR VICE PRESIDENT AND HEAD OF PERSONAL BANKING GROUP, FIRST CHICAGO CORP.**

Mr. HARTNACK. Thank you very much, Mr. Chairman, for the opportunity to speak today. My name is Richard Hartnack. I'm senior vice president of the First National Bank of Chicago.

In the opening of the hearings you asked that we consider two principal questions: Have lenders fulfilled their responsibilities under CRA? And have regulators done their job in enforcing that law?

I would answer the question briefly as follows: some lenders are in the process of fulfilling their responsibilities. All regulated lenders can and should do more in this area. All lenders, and not just banks, not just the regulated lenders, should have the responsibility to reinvest in the communities that they serve, the communities from which they take deposits, and the communities in which they make loans.

If banks alone must shoulder the burden of reinvestment, then they will not be able to meet the need and survive as financial institutions with the competition that they face.

Enforcement by regulators is making progress but is not where it should be to achieve the objectives that were the point of the original law. There are ways to improve enforcement. Improving enforcement does not necessarily mean any kind of sweeping change or radical change in the Community Reinvestment Act.

We do need standards that are specific in individual circumstances. It's unlikely we could have enforcement that would work equally well in all the different communities all over the country. Some structural improvements are required to help both banks and regulators do a better job. Secondary markets for loans like we're facing in inner city Chicago have to be opened up and made available. There's very little access to the secondary markets for those kind of loans. And more capital, more interest subsidy and more entrepreneurs are required in many communities in order to make reinvestment loans work.

Some specific recommendations that we have are to retain the Community Reinvestment Act, expand it to cover all lenders who serve consumers and small businesses, not just regulated lenders, and ask regulators to improve their examination procedures to include community-specific standards and compliance objectives, ratings relative to local peers and similarly situated banks in other markets, and be objective across the board, don't target a bank just because it happens to be a current issue with local community groups. It would be unfair I think for regulators to just pick on the banks that are picked on by particular community groups when the law is designed to apply to all lenders under all circumstances.

There are some things we ought to remember as we try to work together to try to rebuild our cities and strengthen investment in rural America. Banks alone can't shoulder the burden. It's a very, very large job and we should bring in all phases of the economy to make it work. The economics of redevelopment require more inter-

est subsidy, more risk capital and more skilled entrepreneurs. Continued attention to eradicating some of the forces that destroy the inner city are equally as important as trying to reinvest in the city.

I just brought some pictures to show you the type of work that we've been involved with in Chicago and I don't know how to enter these in the record, but there are some before and after shots of buildings we've been involved in the financing of along with a number of other banks in the Chicago area.

This is the kind of thing that we and others have been involved in and can be done and it can be done profitably, but it's not just I think for banks to do.

That concludes my oral testimony.

[The complete prepared statement of Richard C. Hartnack follows.]

One final recommendation would be the establishment of maximum time limits on public involvement in the comment and hearing processes involving CRA performances. The nebulous open-ended parameters of existing law and policy probably do more to frustrate and heighten CRA disputes than they do to resolve them. The regulators are reluctant to mediate, financial institutions are left without guidance, and community groups are not encouraged to focus their concerns on the debate.

#### CONCLUSION

In closing, Mr. Chairman, it would be my personal assessment that CRA has largely realized its goals. The AmeriTrust Development Bank experience is hardly unique. Bankers across the country have come to recognize and address the credit needs of their respective communities in many varied and innovative ways.

This is not to say that some refinements cannot be made to existing law. Indeed, the quest for interagency uniformity in the examination and rating process, built on the solid foundation of objective assessment criteria developed in the ways suggested in my testimony, could prove beneficial to banks and consumers alike. In making refinements, however, it must not be forgotten that CRA is rightfully focused on the bank's

commitment to meet the credit needs of its community. This must remain its mission.

Again, Mr. Chairman, thank you for the opportunity to testify on this important issue. I would be pleased to respond to any questions you may have.

Testimony of  
Richard C. Hartnack  
Senior Vice President and Head of Personal Banking Group  
First Chicago Corporation  
Before the  
U.S. Senate Committee on Banking, Housing, and Urban Affairs  
Washington, D.C.  
March 22, 1988

Mr. Chairman, and Members of the Committee, my name is Richard C. Hartnack. I am Senior Vice President and Head of the Personal Banking Group of First Chicago Corporation, a bank holding company whose subsidiaries include The First National Bank of Chicago, American National Corporation, and First United Financial Services, all in the city of Chicago and its northern and western suburbs.

It may be useful to note that I serve as a director of numerous organizations, among them the Bank Administration Institute, CIRBUS Systems, and the Illinois Bankers Association. In addition, I am also chairman of the Community Investment Corporation, a consortium of banks investing in low-income neighborhoods through a non-profit mortgage banking firm.

It is a pleasure to appear before you, Senator Dixon of Illinois, and the other members of the Committee, to discuss First Chicago's Community Reinvestment Act (CRA) experience.

Perhaps most relevant to these hearings is the fact that I have overseen all CRA-related lending at The First National Bank of Chicago since 1982. I was intimately involved in structuring First Chicago's response to CRA challenges in 1983 and 1984, and was closely involved in our Neighborhood Lending Program from its inception.

Mr. Chairman, First Chicago's motto for the past several years has been, "We put you first, Chicago. We're Chicago's bank." And we do have a very strong sense of responsibility to our community. Specifically, we feel that our banking charter involves a responsibility to address the needs of all who wish to have access to credit, not solely those who are the most attractive from a profit standpoint. And because we are actively involved in inner city communities, we are aware that whatever help we provide, much more work still needs to be done.

Yet, increasingly, in this era of growing deregulation, we also feel strong earnings pressure from the entry and threatened entry of non-bank financial institutions, who are not bound by CRA.

That is why, in my testimony today, I want to both describe our success in meeting our CRA responsibilities, and argue for the need for "non-banks" to meet those responsibilities as well.

I would like to organize my testimony into three segments. First, I will give you a short history of First Chicago's CRA activities. Second, I'd like to offer First Chicago's point of view on the challenges and conflicts presented by community reinvestment. Finally, I'll provide an evaluation of our direct contact with CRA regulatory enforcement and our impression of CRA enforcement of other banking institutions.

### History of CRA Activities at First Chicago

Mr. Chairman, First Chicago has long been a lender conscious of its social responsibility to its community. This has been consistently reflected in the favorable results of our reviews from the Office of the Comptroller of the Currency.

Up until 1982, our community activities were of the sort typically seen in any conscientious bank. Our officers were involved in civic affairs. We had an active foundation supporting community charities and civic organizations. Our consumer loans were broadly available and our credit standards were reasonable. We offered deposit services to all economic segments of the community. And we had a mortgage program for single-family mortgages that were salable in the secondary market. We also owned the First Chicago Neighborhood Development Corporation (FCNDC), a subsidiary which we had organized in 1979 to assist in the revitalization of Chicago's neighborhoods through real estate development in low and moderate income areas of the City.

In 1983 (at the time of our acquisition of American National Corporation) we were approached by representatives of several community based organizations, who requested a meeting with our organization's top management. I was the senior manager tasked with investigating the concerns expressed by these community groups.

They were concerns that applied then to most banks in Chicago. Specifically, they centered on the perception that loans were not available for purchase and rehabilitation of small multi-family properties—the dominant type of housing in Chicago's low-to-moderate income areas. Also, it was felt that loans were not available for the rehabilitation of single-family properties, and that there was no organized bank program to finance small businesses. And, of equal concern to housing-and-economic-development activists in Chicago, the existing community-based support organizations were inadequately funded.

Our investigations convinced us that, given the structure of our organization, the community groups' concerns were reasonable, if not totally accurate.

As a result of our meetings, we agreed to enter into discussions designed to develop ways in which First Chicago Corporation could more actively assist in the process of neighborhood revitalization. The Bank agreed that it could and should play a larger role by dramatically increasing its participation in community reinvestment. The Bank accepted—along with community-based organizations—a leadership role. And it also accepted the challenge of becoming a role-model for the banking industry. I believe we have met, and continue to meet, that challenge.

In the past four years, we have achieved what we consider to be quite impressive results. As I list them, I think you will be surprised at the breadth of our community reinvestment initiatives.

### The Neighborhood Lending Division

With the community groups, we formulated an agreement to establish the "Neighborhood Lending Division". It had an initial five-year charter—and let me say that I am certain that this charter will be renewed next year—allowing it to lend \$100 million within Chicago's neighborhoods for the purpose of increasing or improving the housing stock, improving business properties, and helping small business grow.

We established the Neighborhood Lending Division as an arm of our Personal Banking Group, but it is answerable on policy and pricing to a Board composed of an equal number of community group representatives and Bank representatives. The Division has been staffed with some of our brightest officers, all with strong credit analysis skills. It was important to us that we identify individuals able to respond flexibly to the unique needs of our borrowers. Yet they also had to be people who could understand and adhere to prudent lending practices. We didn't want to gain a reputation as the lenders who always said no, or as the lenders who let borrowers invest in projects for which they were not qualified and which could not succeed.

The Neighborhood Lending Division has five different programs. The most popular provides acquisition and rehabilitation financing to borrowers seeking to rehabilitate multi-family (four or more units) properties in low-to-moderate income areas of Chicago. Most of our multi-family loans are for properties from six to eighteen units, and most loans are in the \$100,000-\$600,000 range. We also frequently provide loans of up to \$1 million for larger properties. Loans of \$1 to 1.5 million are infrequent; loans greater than \$1.5 million are very rare, indeed.

We also provide financing for borrowers seeking to acquire and rehabilitate one-to-four unit properties in the same targeted areas I just described to you. Financing is also available for commercial and mixed-use projects anywhere in the city. (The reason we do not limit commercial and mixed-use projects by neighborhood location or by rehab requirements is that we wish to support community economic development without geographic limitation.) In addition we offer a fixed asset financing program.

Our pricing is extremely competitive, and we have earned a reputation within the city both as the leading neighborhood banking program and as the bank most willing to undertake complex deals. We have developed an expertise in structuring public/private partnerships where City, State and Federal funds are used to leverage our own in order to maximize the "do-ability" of the deals. Loans to not-for-profit organizations are made on a non-recourse basis.

Our program has also reaped more than the obvious benefit of community reinvestment for a number of the community groups involved in Chicago redevelopment. We accept loan applications both directly and through certified loan packagers. Pricing is the same, whichever route is chosen. If a certified loan packager is used, the loan packager, rather than First Chicago, receives any points charged on the transaction. All of our certified loan packagers are



community organizations actively involved in economic and community redevelopment in the city of Chicago.

#### *First Chicago Contributions to Community Organizations*

First Chicago had for many years used our First Chicago Foundation as a means to assist various charitable and cultural organizations in the city of Chicago. Beginning in 1984, we altered the emphasis of the Foundation to make available more grants to community-oriented and neighborhood-based organizations, not-for-profit developers, and technical assistance groups. We added to our staff an expert in neighborhood lending (drawn, incidentally, from our successful Community Development Corporation, about which I will speak more later). Part of this individual's job is to engage in dialogue with neighborhood-based not-for-profit developers and advocacy groups about neighborhood needs which they recommend for consideration by the Bank's Contributions Committee.

In 1985, First Chicago developed an innovative way of sharing its business skills with neighborhood development organizations: venture capital-type grants. These major grants provide equity for the enterprises of non-profit economic development organizations.

In 1988 the Bank intends to make available over \$800,000 for grants to community-oriented organizations and technical assistance groups.

#### *Community Investment Corporation*

First Chicago has taken a leadership role in guiding the Community Investment Corporation (CIC), a consortium of 24 banks cooperatively lending in Chicago through a non-profit mortgage banking firm. CIC includes a professional staff of 20, responsible for originating and processing mortgage loans and making recommendations to a loan underwriting committee composed of loan officers from all participating institutions who provide CIC's liquidity and funding.

The Bank is deeply involved as one in a pool of lenders on CIC's multi-family property rehabilitation program. This program involves the issuance of first mortgages on multi-family properties for rehabilitation and permanent financing. Additional leverage is achieved through secondary financing provided by the City of Chicago and the Chicago Energy Savers Fund.

Total CIC loan volume is \$69.5 million, of which First Chicago has a 21.5% share.

We have made available \$15.5 million for the purchase of CIC participation notes used to fund mortgages, with a commitment to recycle that money as the loans are paid back. At 10/1/87 (the most recent date for which data is available), existing loans purchased by us totalled \$10.2 million, and another \$5.3 million was available.

First Chicago also manages for CIC a \$10 million participative line of credit, of which \$5 million is provided directly by First Chicago on a "first-

in, last-out" basis. Additionally, to give CIC liquidity to make further mortgage loans, First Chicago has purchased \$4.7 million in mortgages from that organization's portfolio.

#### *First Chicago Neighborhood Development Corporation*

As I noted earlier, First Chicago had established in 1979 a Community Development Corporation, the First Chicago Neighborhood Development Corporation. FCNDC created partnerships with neighborhood-based development groups to develop projects that would catalyze neighborhood revitalization.

FCNDC's first project was the Parkways, a \$25 million multi-family residential development located in Chicago's South Shore community that was completed in 1982. In 1983 FCNDC completed Quincy Court, a \$1.2 million multi-family residential development located in Chicago's South Austin community. A joint-venture with the local Neighborhood Housing Services consisting of the redevelopment of a 50-unit residential building on the City's West Side was completed in the summer of 1984. Lockwood Terrace, another South Austin community joint venture with FCNDC and the Peoples Reinvestment and Development Effort (PRIDE), a community-based development group, was also completed in 1984. The formerly vacant building now provides rehabilitated subsidized housing for 18 lower and moderate income families. PRIDE was managing general partner of the project during the development period and now acts as property manager.

FCNDC's most recent two projects, joint ventures with The Neighborhood Institute, a non-profit affiliate of South Shore Bank were completed in early 1988. They consisted of the rehabilitation of a 21-unit building, and the construction of ten new townhomes.

In 1988, FCNDC adopted a new business plan that combines FCNDC's investment capital with funds made available by other Chicago-area corporations for investment in neighborhood-sponsored low-and-moderate-income housing development. These pooled funds are administered by the Chicago Equity Fund, which I'll describe now.

#### *The Chicago Equity Fund*

The Bank helped to found and fund the Chicago Equity Fund, to supply capital to not-for-profit housing developers focussing on low and moderate income development.

The Chicago Equity Fund (CEF) manages a pool of investment capital created by fifteen major Chicago area corporations as investment partners. Returns to investors in all Chicago Equity Fund partnerships consist solely of tax benefits, most recently made possible by the tax credit for low and moderate income housing development created by the Tax Reform Act of 1986.

The CEF concept was developed through the efforts of a citywide task force led by representatives of Chicago United, a consortium of business executives

dedicated to improving social and economic conditions in Chicago. (Barry Sullivan, First Chicago Corporation's Chairman, is the present Chairman of Chicago United, and First Chicago's former Chairman, Gayford Freeman, as well as the then-head of the Bank's Community Affairs Department, were instrumental in founding Chicago United in 1968.) The basic concept is to channel investment dollars pooled by corporate investors into low-and-moderate income housing developments in Chicago.

To date, the various CEF partnerships have invested a total of \$15 million in neighborhood-sponsored low-and-moderate income housing. These developments represent a total of 1,500 housing units throughout Chicago. Typically, a CEF project investment covers 20% of a project's total development cost, with a mix of conventional and city-subsidized financing funding the remaining project costs.

Mr. Chairman, it is interesting to note that First Chicago has been involved in the CEF partnerships in several ways. Through our First Chicago Neighborhood Development Corporation, we will have committed \$1 million to the CEF investment fund by the end of 1988. Through our Neighborhood Lending Division, we have been private lender on three CEF-backed housing developments, with more in the approval process. Also, through FCNDC, we provided the initial equity and technical assistance needed to complete a project that was eventually targeted for investment by the CEF.

#### First Chicago's Point of View

Mr. Chairman, now that I've presented a synopsis of First Chicago's community reinvestment history and role, I'd like to go into what our experience has taught us about the opportunities, challenges and conflicts of community reinvestment.

For one thing, we have learned that it is possible for a Bank to expand its community reinvestment activities safely and moderately profitably. Our experience indicates that most savings and loans and banks can prudently, efficiently and effectively do more in the neighborhood reinvestment arena than they are currently doing.

To be honest, we got off to a slow start with our Neighborhood Lending program because it took us a while to learn the business, the individual communities' concerns and needs, and the players involved.

At 4/30/85, one year after the program's inception, we had approved only 21 applications for a total of \$3.2 million. Less than three years later, however, we have approved (cumulatively) over 150 applications, for a total of \$36 million. We have financed approximately 1,300 units of housing, all in the inner city of Chicago. (Comparable figures are not available for commercial properties.) Roughly 80% per cent of the dollar volume of our approved loans has been in multi-family projects, with the remainder divided between single family and mixed use/commercial/retail assets. Our decline rate has been roughly 30%.

To date we have had only one loan loss, \$16,000 on a commercial loan to a retailer. We do also have a \$200,000 loan in default at this time. For several complex reasons, the tenants of this 18-unit building declared a rent strike, and our borrower fell behind on her payments.

The Neighborhood Lending Division was a minor loss-generator until last year, when the volume of the portfolio reached a critical mass sufficient to generate enough interest income to put the operation into the black. The Division generated positive income of \$254,000 in 1987.

So, over time and with care, as an institution committed to generating profit for our shareholders, we have had a good experience with community reinvestment. However, it is important to remain cognizant of several key points:

First, the figures I just provided should not be regarded as benchmarks. Every bank is in a unique position, and community reinvestment programs still have fairly short histories. Thus, objective standards as to appropriate investments and expectable returns probably are not practicable at this time.

Second, the profitability of the total enterprise is critical. If the total financial institution does not succeed, its community reinvestment program will not have much of a long-lasting effect. As you may be aware, Mr. Chairman, our organization is currently dealing with the challenges posed by the current and upcoming (1990) further deregulation of what has long been a unit banking state. We have, in the past year, undertaken the acquisition of two suburban bank holding companies critical to the success of our strategy. This is an expensive proposition but one we feel critical if we are to maintain or improve our market share in the face of increasing competition from both bank and non-bank competitors from in-state and out.

Third, First Chicago's support of community reinvestment must necessarily mean that fewer resources are available to support other strategic initiatives. As we move to contributing 2% of domestic earnings to our Foundation, the support of community activities comes at the cost of lower support of cultural and health maintenance activities.

Our Community Reinvestment experience has also clearly shown us that the credit and investment needs of less advantaged communities remain keen.

Our programs, and the programs of other banks that have established similar responses to the Community Reinvestment Act, are assisting to meet the needs of these communities. Yet much much more remains to be done.

•Neighborhood disinvestment is still a problem. It is not hard to imagine that the problem will be exacerbated if community needs continue to grow without commensurate growth in the number of institutions providing CRA assistance.

•There is a critical shortage of entrepreneurs and risk capital qualified to employ loan funds available.

•Additionally, while the CRA has raised visibility of neighborhood reinvestment issues, and developed—in some ways, mandated—a very healthy dialogue between the private and non-profit sectors, the dialogue has been conducted in the context of dwindling public sector funding of these programs. Developer/private financier partnerships seeking gap financing from public sources are finding it increasingly difficult to locate, and developers desperately need interest rate subsidies or outright grants to make housing work for low-income people.

Can banks and savings and loans meet the increasing private sector requirements all by themselves? We do not believe that they can, nor that they should have to try to do so.

There is another private sector group to logically involve in CRA activities. This is the group of "non-bank" institutions that accept "deposit-like" funds and/or make loans to consumers. This group would include, in addition to the banks and savings and loans already subject to CRA surveillance: mutual fund companies; insurance companies; mortgage brokers, investors, and lenders; finance companies—including the automobile companies; retail stores that finance purchases; credit card companies; brokerage houses, and so on.

Mr. Chairman, mortgage bankers currently originate nearly 75% of the FHA/VA mortgages and over 25% of all conventional single family mortgages made in this country. Finance companies supply approximately 25% of the consumer credit in the U.S., and they account for almost 14% of all commercial and industrial loans.<sup>1</sup> Securities firms collect deposits for cash management accounts that function as combined savings and checking accounts. They broker commercial paper, directly competing with us in the commercial loan market. And they have acquired "non-banks", which have bank charters and are eligible for federal deposit insurance so that they can offer insured deposit accounts.

Increasingly, these financial service providers are looking like banks. In many areas, they compete with us directly. Yet, Mr. Chairman, they are not subject to CRA and do not in general acknowledge any responsibility to serve the

<sup>1</sup>Source: *The Bankers of Today, The Banks of Tomorrow: The Financial Services Industry and its Role in Community Reinvestment*. The Woodstock Institute, 1987, Chicago.

relatively less profitable credit and deposit needs of low and moderate income people and communities.

The inevitable conclusion here, both from the context of leveling the playing field for all financial competitors, and the standpoint of the needs of neighborhood reinvestment, is that the responsibility to reinvest in communities is not, and should not be, a unique responsibility of banks. Equal responsibility must fall on all institutions that accept consumer deposits or "deposit like" funds, or that make consumer loans.

I know that some people believe that tougher CRA requirements should be a cost accompanying expanded powers for banks. Mr. Chairman, First Chicago takes a different view. We believe that the cost of servicing the credit and deposit needs of the public is compliance with CRA for all providers—including, but not limited to, banks. We believe that the focus of increased CRA compliance should be on those—banks and others—who have done the least to date. If everyone gets up to the level of the leaders, then we can productively talk about raising the standard for all.

If these organizations prefer not to evince their CRA commitment through lending activity, there are many ways in which they can reinvest in communities besides direct lending—which, is, to be frank, the most costly and most difficult. Let me list just a few ideas:

•Companies can agree to invest in loans produced by non-profit lenders like the Community Investment Corporation

•They can form an equity fund to provide development capital (e.g., Chicago Equity Fund)

•They can make direct grants to community based groups

•They can arrange with banks to subsidize interest rates on certain types of loans

•Or they can develop delivery mechanisms that allow for products to be tailored to specialized needs in areas where standard products are not appropriate.

#### CRA Regulatory Enforcement

Mr. Chairman, now that I have spoken on the Bank's experience with CRA and on our perceptions of its success and its need for further application, I would like to provide you our impressions of the CRA regulatory apparatus and our experience with CRA enforcement.

The CHAIRMAN. Thank you, sir.

Mr. Kolesar, I was very interested in your presentation. You head a relatively modest sized branch or I should say part of your holding company. How large is your holding company overall?

Mr. KOLESAR. I believe at last count about \$12 billion.

The CHAIRMAN. And the bank that you head is located where?

Mr. KOLESAR. In Cleveland.

The CHAIRMAN. And again, what is the capital of that bank?

Mr. KOLESAR. Current capital is approximately \$5.1 million.

The CHAIRMAN. And what are the assets?

Mr. KOLESAR. The assets in total are \$40 million.

The CHAIRMAN. This is a great success story and I was delighted to hear it, although it's of course small in relationship to the overall AmeriTrust.

Is there any likelihood that AmeriTrust will, on the basis of this success that you've had in Cleveland, try this elsewhere?

Mr. KOLESAR. Absolutely. I already have a mandate from our holding company board to take a fair amount of time this year to look at Columbus and Cincinnati, two other Ohio cities, where AmeriTrust has just established a presence during the past year.

Those clearly are on the list to look for replication of the development bank. Second, down the road, in a future road, although we need to begin looking at it, is we've made a series of recent acquisitions in Indiana.

Our ideal goal is to be able to replicate the development bank in any community that (a) needs one; and (b) where it's warranted where the corporation has a presence of its own. But we're certainly looking at Columbus and Cincinnati in the short term.

The CHAIRMAN. Now as I say, I'm very impressed and very supportive of the position you've taken, but some people would argue that this is a very small part of AmeriTrust overall and they would argue that by compartmentalizing your low and moderate lending services you're highly in activities that otherwise is comparatively small. So what percentage is your mortgage lending to total home mortgage lending at AmeriTrust?

Mr. KOLESAR. Our home mortgage lending in each of those first 2 years averaged about \$10 million, a shade less than that. Our lead bank's total home mortgage lending—and I think to be accurate we have to say in Cleveland because that's where the proper comparison ought to be—we do some lending in some other areas—approximately \$75 million, if I had to put a number on it. So we're talking about 15 percent of the total real estate lending.

The CHAIRMAN. AmeriTrust intends to move ahead in this area and you've given me some good documentation on that. What evidence is there that other banks might, on the basis of your example, move ahead? Have any of them inquired or suggested or any of your holding company officials indicated that others may get into this operation, too?

#### WILL OTHER BANKS MOVE IN THIS DIRECTION

Mr. KOLESAR. I can talk about that on two levels, one locally and another one more nationally. Locally, no. Quite honestly, none of



the other major banks in Cleveland has indicated an interest in doing a development bank per se.

What I think we have succeeded in doing, though, is creating some competition in neighborhood lending because each of the other major bank holding companies headquartered in Cleveland have in fact, since the development bank was established, gone about the process of creating these neighborhood lending departments to beef up their investments in low and moderate income areas. So there are at least some important steps in that direction.

On a national level, because of my involvement with CBA, we get called upon often to come and talk about this. In fact, I'm on my way this afternoon to Philadelphia. A group of banks there are interested in doing a development bank. I understand there's an effort afoot here in Washington, DC.

Our bank was visited last week by a representative—I don't want to name names because I'm not sure that they're prepared to do this—but from a very large bank holding company on the West Coast that is very far along in the process of actually planning a development bank throughout the State of California.

So, yes, I think we're beginning to see some movement in that direction.

The CHAIRMAN. Mr. Hartnack, the First National Bank of Chicago is one of the big banks of our country. Are you the largest bank in Chicago now?

Mr. HARTNACK. Yes, we are.

The CHAIRMAN. And what proportion of your assets are invested in home mortgages?

Mr. HARTNACK. We have a loan portfolio that we own through our primary bank of just about \$1 billion in home mortgages, although we certainly have originated a great deal more than that. We've sold many in the secondary market.

The CHAIRMAN. And Illinois is unusual. Until very recently, you didn't have branch banking even within the State, is that right?

Mr. HARTNACK. That's right, and we really don't have branch banking beyond five branches with limited distances.

The CHAIRMAN. So much of your lending has been in Chicago, your mortgage lending.

Mr. HARTNACK. Within the personal banking group where we make residential real estate mortgages, virtually all of it has been within the 6-county area.

The CHAIRMAN. And how much of that has been within the city itself?

Mr. HARTNACK. Oh, I couldn't tell you that exactly. A large portion of it. We've been over the last 5 years averaging between \$150 and \$200 million a year of conventional real estate mortgage lending and I don't know the statistic but I'd be pretty confident in saying that 60 to 70 percent of that is within the city of Chicago, although there are some very, very affluent areas within the city of Chicago.

The CHAIRMAN. Yes. I grew up in Lake Forest.

Mr. HARTNACK. Right.

The CHAIRMAN. Of course, that's not the city of Chicago but it's close enough.

Mr. HARTNACK. That's right.



The CHAIRMAN. I shouldn't have said it quite that way. I love Chicago, even though the Cubs are going to have lights, I still love Chicago.

Would disclosing your CRA rating trouble you at all?

Mr. HARTNACK. To be honest, I don't think it would be a serious problem. As I've said in other parts of my testimony, it's important that we really have a very level playing field among all banks, not just national banks, but all banks, all savings and loans, State banks, State-regulated credit unions, mortgage companies, brokerage firms, insurance companies.

The CHAIRMAN. Well, I agree with that. I think that's very helpful and we're going to push for that, but the present CRA rating doesn't mean very much, does it?

Mr. HARTNACK. To be honest, it doesn't.

The CHAIRMAN. So I would think that banks that are doing a conscientious job would favor having a more critical kind of rating system. If a substantial number were given C's or D's or E's or F's or whatever, that would seem to me to be to the advantage of those banks that are conscientiously trying to do better, is that right?

Mr. HARTNACK. I think it would. I think it would be an advantage.

The CHAIRMAN. What's the sentiment among your fellow bankers in Chicago? Do you think they would be opposed to or favor having more rigorous CRA with regulators that provided a variety of ratings instead of everybody getting an A?

Mr. HARTNACK. I couldn't really speak for all the bankers in Chicago. There are more than 400 banks. But there are some 24 of us involved in the Community Investment Corp., a consortium. I would guess that that group would probably not object, although I really can't speak for the industry on the topic because I haven't ever asked anybody that question.

The CHAIRMAN. Let me ask each of you this. With the emergence of interstate mergers—the population of banks is expected to dwindle. Concentration means lending decisions will be handled by bureaucratized, distant decision-makers. Studies show that larger institutions favor the big loans over the small and hire sophisticated staffs whose climb up the corporate ladder leaves little time for mastering a neighborhood.

In your case, you both have large banks and you seem to be an exception to that generalization. Are your efforts central to your banks' future or dead end alleys?

#### PERFORMANCE AND BANKS' FUTURE

Mr. HARTNACK. Well, I think, speaking for my personal banking group, we knew when we got into this, after spending some time in Chicago's neighborhoods, that the only way to succeed was to put the best people that we could get in the bank who are motivated to do personal and small business lending into the area and it has been by design a career enhancer for everybody that's gotten near it.

Mr. KOLESAR. And I would say the same for ours as well, Senator. It really is essential to the future of the bank, as I said before, in any market that we go into, not only so that there is no question

in that community about what the bank's commitment is, but because—as we found—it's good business. We discovered a market there that we didn't know existed before, at least not to the extent we found it.

So it makes sense for the bank just on a business basis.

The CHAIRMAN. In general, I think banks somehow must be doing a pretty good job with respect to small business. Let me give you a statistic that really startled me. Since 1980, we've had an increase of 9.5 million jobs net. All those jobs have been in small business; that is, businesses that employ 500 or fewer people. Businesses who employ more than 500 people have declined in the number of jobs by 600,000 during that time. More than half of the increase has been in businesses that employ 50 or less people.

Now that suggests that small business is really the dynamic moving element here and, of course, small business can't really grow unless they get credit, and for that reason it seems to me that the banks overall must be funding small business.

The problem, however, is discrimination within neighborhoods that CRA was designed to work on rather than small business itself.

What is your feeling about this? Do you feel that big banks do have a sufficient concern for small business and really make an effort to lend to them?

Mr. HARTNACK. I do.

The CHAIRMAN. Another factor that bothers me is that the biggest banks in this country, the money center banks, lend about 12 percent of their loans to small business, and the medium sized banks loan about 70 percent and the small banks about 90 percent. That's one of the reasons why I'm concerned about the concentration of banking.

Mr. Kolesar, your bank is a medium-sized bank. It's not a money center bank; is that right?

Mr. KOLESAR. No. We're considered a large regional bank. I think particularly, Senator, when you put the question in terms of interstate banking, at least what's now being called the super-regionals, that that small business lending market is part of the motivation for crossing a State line.

Even if we were primarily—and AmeriTrust is not—but even if we were primarily big business lenders in Cleveland, as we cross the line into Indiana, for instance, it's for retail deposits on the deposit side, and on the credit side it's primarily for that small business market niche. If we weren't interested in that market, we would have no reason to go into those areas. If anything, it's a real driving force on the interstate banking side.

Mr. HARTNACK. I think that goes for us. In order to increase our effectiveness in that market, we've made three fairly sizable acquisitions of banks that were specialists in that market and have managed those banks to enhance their effectiveness, not detract from it, in serving medium and small sized businesses.

The CHAIRMAN. I'm told there are plans for closing more inner city branches of banks. How would such closings affect neighborhood credit needs and are there are ideas around for maintaining services to neighborhoods losing branches?

## EFFECTS OF CLOSURES OF INNER CITY BRANCHES

Mr. HARTNACK. We don't have branch banking in Illinois in the way that I think most people think about it. So we're certainly not planning on closing inner city branches. I'm not aware of people that are in our market having such plans.

Mr. KOLESAR. I think that any bank that has a large branch presence, No. 1; and No. 2, has any sense at all, has got to begin looking broadly at their whole delivery system. It's a very expensive way to do business. We recognize that can have much more deleterious effects in an inner city location where, for instance, in AmeriTrust's case we are the only branch left in a number of neighborhoods because the other Cleveland banks either never went there in the first place or have long since left. So we are their lifeline, if you will.

What we have to consider and in fact are considering is rather than an out and out closing of that facility, to shrink it perhaps, to reduce our costs, to have it open on limited hours, so that those essential deposit transactions for the neighborhood are kept available on the one hand. On the credit side, it's a little bit easier to continue to meet the credit needs without having an actual physical presence there. Technology as simple as a telephone can accomplish that, and we and some other Cleveland banks have had some luck with.

But there's no question, it's a tough issue that we and the neighborhoods need to deal with and, ideally, do it in a partnership fashion so they can tell us what those essential needs are that we need to keep in place.

The CHAIRMAN. In view of the minimal regulation by the regulators with respect to the CRA, do you gentlemen have your own measures of progress in meeting community credit needs in view of the fact that the legislation is so feeble and so ineffective? You both seem to feel that you've done well and I think you probably have. So what measures do you have to judge your own operation?

Mr. HARTNACK. We measure ourselves on several different measures. One is we have an agreement to try to place \$100 million in loans in the Chicago area over the term of a 5-year commitment. We measure ourselves against that. We likely won't make \$100 million in that 5-year period, but we will extend our side of that agreement in order to get it. So that's a benchmark of how are we doing against that \$100 million.

We participate in an organization called The Community Investment Corp. It has an annual loan production goal of about \$20 million a year. It has an annual budget that we participate in managing and we hold ourselves accountable for that and then we continue to measure the profitability of the activity in order to sustain it.

Mr. KOLESAR. We use two measures, Senator. First is an internal and absolute one for ourselves. At the beginning of each year we set a very specific target of how much we hope to be able to lend in low income areas in the course of that year. During our first 2 years we way underguessed—as I mentioned in my testimony—at \$5 million each year and in 2 succeeding years exceeded that substantially. This year's target is closer to \$15 million. So far I think we can make it.

Our second measure is a comparative one in terms of the amounts of dollars that we are investing in low income housing in Cleveland vis-a-vis other Cleveland banks, including our lead bank. The measure that we use for that is really two—one is HMDA data that's available, although by and large we find that to be not terribly reliable. What we find to be far more reliable, however, is that Cleveland State University goes into our county recorder's office and records title transfer data by lender for each census tract in the city of Cleveland that gives us a much more accurate figure than the HMDA Disclosure Act of what all lenders are doing in low income areas. That's what we use as our comparative measure on how we measure up to the other lenders in Cleveland.

The CHAIRMAN. Both of you can give me a quick expert opinion on this final question I have.

You have talked about the profitability and safety of lending in lower income neighborhoods. You did mention a few losses and defaults, Mr. Hartnack.

Mr. HARTNACK. Right.

The CHAIRMAN. How does your rate of losses and defaults compare with the bank's general default rate, higher or lower?

Mr. HARTNACK. So far it is lower.

The CHAIRMAN. It is lower?

Mr. HARTNACK. It is lower.

The CHAIRMAN. Can you give me the proportion? Is it 10 percent lower, 50 percent lower?

Mr. HARTNACK. It is not perfectly comparable. There's a little bit of apples and oranges here. But I would say that currently we're probably running something that would maybe be 60 to 70 percent of what we would expect based on previous experience. But previous experience is much more aged, so we don't have the final chapter written yet. But I will tell you, as an expert, I'm confident we will be able to maintain the loss ratios at a level not worse than what we can achieve in other parts of the business.

The CHAIRMAN. Mr. Kolesar.

Mr. KOLESAR. We've had a grand total of exactly two defaults in our 2-year history and one was a very small home improvement loan.

The CHAIRMAN. Out of how many loans?

Mr. KOLESAR. Out of, in total, approximately 475 individual loans.

The CHAIRMAN. And only two defaults?

Mr. KOLESAR. Yes. In fact, on one, although we've charged it off, I think there will be some recovery there. Now that obviously is dramatically better than not only our lead bank but any other bank that I know of, but I'd go back to the comment that Dick made about the aging issue. We've only been in business 2 years. Come back and ask that same question 3 to 5 years from now and I may have a different answer. But I firmly believe it will still be better.

The CHAIRMAN. Gentlemen, thank you very much. I want to say that these hearings this morning with all the witnesses and all the three panels have been outstanding. I've been here 30 years and I don't think I've heard wiser or more thoughtful or more helpful testimony. Thank you very much.



The committee stands in recess until tomorrow at 10 o'clock.  
 [Whereupon, at 12:45 p.m., the hearing was recessed, to be reconvened Wednesday, March 23, 1988 at 10 a.m.]

## COMMUNITY REINVESTMENT ACT

WEDNESDAY, MARCH 23, 1988

U.S. SENATE,  
 COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,  
*Washington, DC.*

The committee met at 10:05 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Graham, Garn, D'Amato, and Bond.

### OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

This is our second day of hearings on the Community Reinvestment Act. We hear from mortgage industry executives and Federal regulators.

Yesterday, a witness summarized the first 10 years of the Community Reinvestment Act activity with three numbers—74, 97, and 8. A 74 percent reduction in examination manhours, 97 percent of institutions received good CRA grades from regulators, and 8 denials out of 40,000 applications.

Today, we need to hear from you concerning the three E's that are the essence of CRA—examinations, evaluations, and enforcement.

Frankly, it's time to raise tough questions and get serious responses. I wonder if your examinations are for real. A banker told us yesterday, and we've heard it many times before, that nobody worries about the CRA exam, neither the lender nor the examiner. Why should they? Virtually everybody passes.

Does your grading mean anything? Neither lenders nor community groups appear to think the ratings stand for anything or give them credibility. Why should they do that if most everybody gets the same rating?

Will there be any serious enforcement using either the carrot or the stick? The record indicates that lenders don't have to fear rejections and have little incentive to improve.

CRA was written to nudge lenders. You are the nudgers. Your examination, evaluation, and enforcement procedures are meant to encourage lenders to make more loans in their own communities.

We asked community representatives yesterday to grade your agencies' performances. What did we hear? F. The only A was in public relations. Moreover, the community groups charged that they're doing your enforcement work and, as a result, you're pitting community groups against community lenders.

Governor Seger, Chairmen, and Mr. Comptroller, you've heard the charges. We'd like to hear your views and your responses. I hope to hear both good explanations and possible pledges to improve performances. After all, I know that you want to see CRA succeed and certainly we do, too.

Governor Seger, go right ahead.

#### STATEMENT OF MARTHA R. SEGER, GOVERNOR, FEDERAL RESERVE BOARD

Ms. SEGER. Thank you very much. I hope that's not because of ladies first, is that right?

The CHAIRMAN. No, indeed, no sexism from this Senator.

Ms. SEGER. I'm very pleased to be here today to discuss the Community Reinvestment Act and the role the Fed has played in administering it.

As the Board Member responsible for our program of compliance with CRA and the other consumer protection laws, these issues have received a great deal of my own thought and attention. I believe that it is appropriate, even essential, that we periodically stop and reflect on what we have been doing with respect to this law, as well as the other laws for which we are responsible. So I compliment you, Senator Proxmire, and the committee for holding these hearings.

The Federal Reserve's overall program for dealing with CRA responsibilities consists of a compliance examination program, a community affairs program, and a program for dealing with applications by banks and bank holding companies when CRA issues arise. We believe this three-part program meets the law's requirement that we encourage our banks to lend in their entire communities, assess their record in examinations, and take their records into account when considering applications.

#### COMPLIANCE EXAMINATION PROGRAM

I want to emphasize that our compliance examination program begun in 1977 is a specialized program. It is carried out by examiners who are specifically trained in consumer compliance and CRA issues and whose primary job it is to conduct reviews and produce reports that deal exclusively with consumer complaints and CRA.

We believe that the importance of this program warrants this kind of specialization and that the knowledge and expertise necessary to deal effectively with these laws requires it. Our examiners are hired and managed by each Reserve Bank and they participate in examinations of State member banks in their own districts.

The Board here in Washington sets policy for the program and also provides oversight and support for the Reserve Banks. The Board also organizes the uniform training program for the examiners. Our examiners have contacted thousands of members of the communities in which they have conducted examinations, everyone from local Government agencies to small businesses to grassroots community organizations, in an attempt to understand the needs of the community the bank serves. With this information we try to encourage the bank to meet these needs.

We believe our examiners' efforts in this respect have been particularly useful to the banks and their local communities.

#### COMMUNITY AFFAIRS PROGRAM

Through our community affairs program, begun in 1980, we have developed special expertise to work with and encourage the banks in designing community development programs. The program's main purpose has been to develop our own expertise in the methods and techniques of sound community development lending in order to be able to serve as a resource for banks and members of the communities.

It is the goal of the community affairs program to become familiar with the credit needs of the cities, towns, and rural areas in the Federal Reserve districts through outreach to those areas, and to work in a variety of ways with interested parties to address them. For example, over the last 3 years alone the program has sponsored 89 conferences and seminars on opportunities and techniques for community development lending and other related subjects.

The Reserve Banks have undertaken additional initiatives to help lenders and others in the community know what the needs are, what resources are available, and what contribution the various interests might make. All of these efforts are, we believe, consistent with the act's mandate that we "encourage" financial institutions to meet the credit needs of their communities.

I have brought along some other materials that represent these activities that I would like to have included in the record of these hearings.

The CHAIRMAN. I'd just like to announce that we've had from time to time appearances before the committee in which people have requested that their official reports be printed for the record and I understand—we've been checking it—it would cost several thousand dollars because these reports are very large if we printed them in the record. So we will keep them in the Committee files available for inspection, but we will not print them as a public document.

Ms. SEGER. I believe that we as regulators can best use our resources by encouraging the institutions we supervise to explore various ways to increase their community involvement. If we are successful in encouraging long-range activities, such as forming community development corporation subsidiaries or involvement with the Neighborhood Housing Services programs, we stand a much better chance of getting ongoing, high quality community development lending, rather than programs specifically calculated to win approval of a particular application.

Dealing with CRA in the context of the applications process has been the part of the program that has raised the most serious concerns for the Fed, financial institutions, and the community groups who have claimed a large stake in the process. Frankly, it's often been a contentious process and has been of great concern to me personally.

One reason for this is simply the sheer number of protests in the last few years. In addition, the cases have become more complex. For example, more applications now involve interstate acquisitions



and have more frequently involved multiple protestants in several cities, often crossing our Federal Reserve district lines.

Obviously, the ultimate resolution of cases that raise CRA issues, whether or not they are protested, has required the Board to exercise a great deal of judgment since no two cases present identical facts or issues of policy. The Board chose in the early years of the law's existence to emphasize obtaining commitments for future improvements when presented with a record that had specific areas of weakness. It has been the Board's belief that as a general matter working in a positive vein with these institutions, rather than simply turning down the application, was consistent with the law's mandate that we encourage these institutions to meet the credit demands of their communities.

The type of review conducted when problems surface varies with the circumstances and the issues raised. Typically, it will involve a review of the Home Mortgage Disclosure Act data, any data available in Reserve Bank examination files, information supplied by other examining agencies, including, on occasion, State agencies, any data supplied by the protestant, and information supplied by the financial institution in response to the protest or in response to requests for information from us.

Obviously, all of this takes time and time is often the point of contention between the applicant, the protesting group, and the Federal Reserve. Many of these applications are very time sensitive and delay can increase the applicant's costs substantially or may cause the deal to fall through.

We believe our processing period is long enough for all parties to get a fair review of their views. To help speed this process, we urge groups to communicate concerns to the applicants and to the Federal Reserve on an ongoing basis, not just when an application is filed.

One procedure that has been used to deal with CRA issues that arise in the context of applications has been to provide a forum for protestants and applicants to sit down together in private meetings and discuss the issues between themselves. Though we do not insist that they do so, sometimes these meetings have resulted in agreements between the parties. These agreements are essentially private matters.

We do not believe the law authorizes us to direct banks to make loans of certain types with specific terms in particular amounts or to specified locations. We believe that lending decisions are best left to the informed judgment of the lender, taking into account the market situation, the lender's own business plans and strengths, and all the credit demands of its community as required by the Community Reinvestment Act.

Obviously, a good deal has changed in the financial world since CRA was enacted. Influences such as interstate compacts, changes in technology, and the Monetary Control Act have significantly affected the way business is done. To be sure that we are as responsive as we can be in supplying guidance on our expectations in today's environment, I have asked our staff to review our programs, policies, and procedures to see where we can improve our program, provide the necessary guidance, and make sure it is up to date.

I appreciate the opportunity to appear before this committee today to discuss this important subject and I will be pleased to take any questions the Committee might have.

[The complete prepared statement of Martha Seger follows:]



As you know, the Office of the Comptroller of the Currency bears primary regulatory responsibility for oversight of CRA for national banks. We have been examined approximately annually by the OCC and each examination has included specific investigation of CRA compliance. We have passed all such examinations.

I would offer the following observations on this examination process:

- While, in my experience, the OCC provides tremendous consistency in the examination staffs on the loan and trust sides of the business, our CRA examiners have changed each year during my tenure.
- Investigation and examination techniques have changed each year.
- Examinations have become more intense as community groups have increased their focus on CRA compliance.
- The OCC lacks, or is unwilling to share, any objective standards constituting compliance or non-compliance with the law.
- There seems to be little difference in the treatment accorded banks based on CRA examinations.

While in general, CRA has had beneficial effects on Chicago's neighborhoods through banking industry participants in our market, these beneficial effects are more due to the work of community based groups than due to the examinations themselves.

I would suggest the following be considered for improving the examination of compliance with CRA:

- Assist banks to better meet their CRA requirements by sharing with them objective, measurable criteria for CRA compliance. Insist on reasonable movement towards meeting compliance standards as a condition of regulatory approvals when required.
- Adjust standards to reflect sheer volume of CRA participants. It is possible to imagine that one day there might be more CRA-related funds available than could be productively or prudently used.
- Standardize the process of gathering community based organizations' testimony about CRA compliance by a particular bank, to ensure that the resulting data is verifiable, statistically valid, internally consistent, and representative of all constituencies within the community.

#### Conclusion

In summary, Mr. Chairman, CRA is a vital and effective means of encouraging those regulated to assist community reinvestment, although the actual enforcement of CRA could benefit from increased professionalization. However, CRA must not be applied selectively. CRA regulation should be viewed as the price of entry to the financial services market.

Thank you.

For release on delivery  
10:00 A.M., EST  
March 23, 1988

Statement by  
Martha R. Seger  
Member, Board of Governors of the Federal Reserve System  
before the  
Committee on Banking, Housing and Urban Affairs  
United States Senate

March 23, 1988

I am pleased to be here today to discuss the Community Reinvestment Act and the role the Federal Reserve has played in administering it. A good deal of time, thought, and effort has been invested by both the Board and the Reserve Banks in trying to carry out our CRA responsibilities effectively and fairly. As the Board member responsible for our program of compliance with CRA and the other consumer protection laws, these issues have received a great deal of my own thought and attention. I believe that it is appropriate, even essential, that we periodically stop and reflect on what we have been doing with respect to this law, as well as the other laws for which we are responsible. Consequently, I am very interested in learning what we might do to improve in the future. I compliment the Committee for holding these hearings. I believe they are timely and will help us all do a better job of administering this important law.

As stated in the statute, CRA was enacted in the belief that financial institutions have a responsibility to meet the credit needs of their entire local communities, including the low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. The Act's mandates are, however, directed in the first instance at the federal financial supervisory agencies. In their most basic terms they are:

- That the agencies encourage the financial institutions they supervise to meet the credit needs of the communities they serve, including the low and moderate income neighborhoods in these communities.
- That the agencies assess the community lending records of the institutions they supervise as part of their examinations.

- \* That the agencies take the institution's record into account when considering certain applications.

The Federal Reserve thus has a three-part program in place to address these mandates. I propose to discuss the various elements of our program in my testimony today, as well as to discuss some of the issues we have confronted over the years in dealing with CRA. In doing so, I may touch upon the questions you raised in your letters of October 22, 1987 and December 23, 1987. In the interest of time, I do not propose to respond in detail to those questions in my statement, since that was done in Chairman Greenspan's letter to you of January 27. I will, however, be pleased to take any questions you may have regarding either my testimony or the material submitted in response to your letters.

#### The Federal Reserve's Overall Program

The Federal Reserve's overall program for dealing with its CRA responsibilities consists of a compliance examination program, a community affairs program, and a program for dealing with applications by banks and holding companies when CRA issues arise. In 1978 the Board and the other agencies published Regulation BB to implement the statute. The regulation sets out several specific requirements financial institutions must address, such as the requirement that the institution delineate its community, develop a CRA statement that indicates the types of lending the institution is prepared to extend in its community, provide a CRA public notice, and maintain a public comment file. It also sets out the criteria the agencies will

use in reviewing CRA performance including evidence of the institution's efforts to assess its community's needs, its marketing of credit services to the entire community, and its efforts to ensure that lending programs do not improperly exclude any geographic areas or illegally discriminate. The assessment factors also include a bank's record of opening and closing offices, its participation in community development projects and in government guaranteed or sponsored loan programs and the bank's residential, small business and small farm lending programs. We also review the extent the institution's board of directors participates in formulating its CRA policies and overseeing their implementation. In fact, I believe that the overall intent of these assessment criteria is to make the CRA process an integral part of the institution's management and operational decision making.

The criteria do not, however, set standards for the type and amount of lending that should be done, nor do they favor one form of lending over another. This is important to keep in mind since I am concerned that CRA has become, over the years, synonymous with home lending in the minds of many. The regulation, however, does not reflect such a leaning. It reflects the very strong belief that a long list of other forms of lending are just as important to the communities of this nation. This is particularly critical to the Federal Reserve, since many banks, which are the institutions we supervise, have not chosen to specialize in home lending, preferring not to engage heavily in the long term mortgage market. We believe,

however, these banks still play a valuable part in meeting other needs of their communities.

The Compliance Examination Program

The Federal Reserve's compliance examination program was begun in 1977. I want to emphasize that, within the Federal Reserve System, this is a specialized program that is carried out by examiners who are specifically trained in consumer compliance and CRA issues and whose primary job it is to conduct reviews and produce reports that deal exclusively with consumer compliance and CRA. We believe that the importance of this program warrants this kind of specialization and that the knowledge and expertise necessary to deal effectively with these laws require it.

Our examiners are hired and managed by each Reserve Bank and participate in examinations of state member banks in their own districts. The Board here in Washington sets policy for the program and also provides oversight and support for the Reserve Banks. The Board also organizes the uniform training program for the examiners, although most of the Reserve Banks also provide more individualized and localized training, as well.

When the program was begun, we examined each State member bank at least once a year. Over the years we have increased the interval between examinations so that at present banks with a better than satisfactory rating are "generally" examined every eighteen months. Some of the best-performing banks may have as much as 24 months between examinations. Banks with less satisfactory records are examined at a one-year interval or more frequently, however.

These changes in the frequency of examination were prompted by two primary factors. First, we found that after some years at the shorter interval, a longer period between examinations proved sufficient to assure an adequate level of oversight. After several examinations, an 18 month interval between examinations enabled us to see and measure progress or change within a particular bank in the great majority of cases. Second, the Board committed to observe the "spirit" of Gramm-Rudman-Hollings, and the compliance program, like virtually all of the System's programs, had to share in the resulting cuts.

Despite fine-tuning such as this over the years, our compliance examination program has retained its essentially specialized character and our goal has been to maintain a solid and professional program. We try to produce an examination report that is useful to the bank's management by pointing out both its strengths and weaknesses and by suggesting how to enhance the former and minimize the latter. Our examiners have contacted thousands of members of the communities in which they have conducted examinations--everyone from local government agencies to small businesses to grassroots community organizations--in an attempt to understand the needs of the community the bank serves. With this information, we try to encourage the bank to meet those needs. We believe our examiners' efforts have been significant, evenhanded, and useful to the banks and their local communities.

The Community Affairs Program

As an outgrowth of our experience in dealing with CRA we have developed one particularly noteworthy area of special expertise to work with and encourage the banks. That is, in 1980 the Board began its formal community affairs program. We have learned that community development lending, when done properly, can benefit both the bank and the community. However, many banks have been hesitant about involving themselves in the more complicated programs and techniques demanded by economic development lending. This hesitancy has been caused primarily, we believe, by a lack of education. We have also found that many members of the communities the banks served, including many of the local governmental lenders, were unaware of the productive ways a bank could leverage its resources in a public/private partnership to benefit all parties concerned. The Community Affairs program's main purpose, therefore, is to develop our own expertise in the methods and techniques of sound community development lending in order to be able to serve as a resource for banks and members of the communities in the various Federal Reserve districts in matters pertaining to safe, sound, productive, and thoughtful community development lending.

It is the goal of the System's community affairs program to become familiar with the credit needs of the cities, towns, and rural areas in the Federal Reserve districts through outreach to those areas. Once having identified these needs, our community affairs officers try in a variety of ways to work with interested parties to address them. For example, over the last 3

on opportunities and techniques for community development lending and other related subjects. On numerous occasions, the Community Affairs staff has also served as speakers at conferences sponsored by others. The Reserve Banks have undertaken additional initiatives, such as publishing periodicals that deal with community lending subject matter, producing resource books on the programs for community development lending in which a bank might wish to participate, forming community lenders forums in communities in their districts to provide mutual education about community development opportunities and techniques, and producing community profiles designed to help lenders and others in the community know what the needs are, what resources are available and what contribution the various interests might make. All of these efforts are, we believe, consistent with the act's mandate that we "encourage" financial institutions to meet the credit needs of their communities. The attachments to my testimony provide more specific information about these and other activities of our community affairs program. I have also brought some other materials that represent these activities that I would like to have included in the record of these hearings.

I would like to take just a moment to speak about three areas of endeavor by the Federal Reserve and the other agencies in which I am particularly interested. First, for about a year now it has been my privilege to chair the Board of Directors of the Neighborhood Reinvestment Corporation. As you are no doubt aware, this organization helps to set up and support the many Neighborhood Housing Services corporations around the country.



Many members of the Federal Reserve's community affairs programs in the Reserve Banks have also participated heavily in this program.

The second activity I would like to mention is our work with community development corporations. Since well before the advent of CRA, the Federal Reserve and the Comptroller of the Currency allowed and encouraged the creation of bank holding company and national bank community development corporation subsidiaries. Community development corporations -- or "CDCs" as they are called -- are corporations chartered to bring the lending, financial packaging, and other special talents of the banker to bear on specific community projects. CDCs may focus, for example, on special community needs such as low-income housing or small business revitalization. These corporations have the potential for making important contributions to community revitalization in part because they are given unusual authority, for example, to take equity positions or own real estate. The Federal Reserve and the Comptroller's office cosponsored a conference in August of 1987 dealing with CDCs. The conference was attended by about 200 bankers and the program has elicited a good deal of interest among the participants.

I believe that CDCs and the MIS programs are two examples of the kind of activity in which financial institutions can usefully and safely engage as part of an overall CRA-related effort. They are also the kind of thing we, as regulators, can responsibly encourage financial institutions to explore. They represent vehicles, already in place, that financial institutions

can use to engage in public/private partnerships to leverage their resources, both financial and managerial, to the greatest benefit in pursuit of the goals of CRA. I believe that we, as regulators, can best use our resources by encouraging the institutions we supervise to explore these and other similar avenues of potential community involvement. If we are successful in encouraging this type of long-range activity, we stand a much better chance of getting on-going high quality community development lending rather than instant, and perhaps short-lived, programs calculated to win approval of a particular application.

The final special project I would like to mention is our work to advise women and minorities regarding their rights and responsibilities under the Equal Credit Opportunity Act when applying for business credit. I believe women and minorities are important actors in the business life of our nation's communities and I am particularly proud of the work we have done to help educate them on this important subject. In particular, I am proud of the brochure entitled "A Guide to Business Credit and the Equal Credit Opportunity Act" that we produced in conjunction with several other public and private organizations and agencies.

The Applications Process

The third part of the Federal Reserve's program for responding to the CRA's mandate that I would like to discuss is our process for taking the CRA record of banks and holding companies into account when considering certain applications. When reviewing an application, for example, by a holding company to acquire a bank, it is the Board's responsibility to see that

the applicant meets numerous criteria. The Board must see to it that all relevant financial and other safety and soundness requirements are met, that the necessary managerial ability will be brought to bear, that no competitive problems would bar approval and that the convenience and needs of the institution's community will be served. The requirement to serve the community's convenience and needs predates the CRA. Therefore, when CRA was enacted the analysis it required was logically made a part of the convenience and needs assessment already required by statute. The CRA analysis thereby became part of the normal applications processing procedures of the Federal Reserve System.

Dealing with CRA in the context of the applications process has been the part of the program that has raised the most serious concerns for the Federal Reserve, the financial institutions, and the community groups who have claimed a large stake in the process. Frankly, it has often been a contentious process and has been of great concern to me, personally. One reason for this is simply the sheer numbers of protests in the last few years. In CRA's early days, the protests were a small part of our work; usually only a handful of cases were handled each year. However, in recent years the numbers of protested applications has increased markedly. In 1987, for example, there were 35, when just three years previously, in 1984, there were three.

In addition, the cases have become more complex. For example, more applications now involve interstate acquisitions. The applications have more frequently involved multiple protests

in several cities, often crossing our Federal Reserve District lines. Obviously, that is of little intrinsic interest to the applicant and the protestant, but it does increase the logistical difficulties of gathering the necessary facts and otherwise coordinating the case, especially when significant issues surface.

To try to expedite the process and minimize these difficulties, in 1981 the Board published an information statement explaining how it would deal with CRA issues that were likely to surface in the application process. It has published jointly with the other agencies a Citizens Guide to CRA to help interested members of the public know how to involve themselves in the applications process. The Board has also made adjustments to its notice, comment and public meeting rules to try to assure that interested parties who wish to participate in the applications process can do so. These rules, however, are not rules relating only to CRA. They are rules that apply to applications generally and to any comments by the public they might elicit, no matter what their subject might be.

Obviously, the ultimate resolution of cases that raise CRA issues has required the Board to exercise a great deal of judgment, since no two cases present identical facts or issues of policy. The Board chose in the early years of the law's existence to emphasize obtaining commitments for future improvements when presented with a record that had specific areas of weakness. Of the 112 cases the Board reviewed between 1978

and 1987 involving CRA protests, 28 have resulted in the applicant committing to the Board to take specific future actions to correct problems with its record. It has been the Board's belief that, as a general matter, working in a positive vein with these institutions, rather than simply turning down the application, was consistent with the law's mandate that we encourage these institutions to meet the credit needs of their communities. Moreover, it was not always clear in these cases that the applicant's CRA record was poor enough to deny the application.

Of course, we have not always waited for a protest to prompt a close review of an applicant's record. When we have found problems in an applicant's CRA examination record, either through our own examiners or those of another agency, we have conducted the same kind of review we conduct in a protested case.

The type of review conducted in these cases varies with the circumstances and the issues raised. Typically it will involve a review of the Home Mortgage Disclosure Act data, any data available in Reserve Bank examination files, information supplied by other examining agencies (including, on occasion, state agencies), any data supplied by the protestant, and information supplied by the financial institution in response to the protest or in response to a request for information from us. The Board considers the types of lending being done in the context of the community's needs. Consequently, although we believe home mortgage lending is important, small business,

agricultural, and other types of lending are also ways of meeting important community needs, as well.

Our purpose in each case, however, is to consider all of the facts and exercise our own judgment about the merits of the matter. This has lead us to approve applications over the objection of protestants when we believed the applicant's record was already consistent with approval. It has also lead us to obtain commitments for improvement when no member of the public objected to the application. I believe that that is the essence of what the law tells us we should do --that is to conduct our own review and reach our own conclusion about the merits of the matter.

All of this takes time, and time is often the point of contention between the applicant, the protesting group, and the Federal Reserve. Many of these applications are very time sensitive and delay can increase the applicant's costs substantially or may cause the deal to fall through. We feel we have to be fair to the applicant and the protestant. To the extent possible, we try to meet our own processing goals, which have long been public and which are designed to address other goals of the Board, including timely processing of all applications, whether or not CRA is involved. By the same token, we believe that we must give thorough consideration to the protestant's substantive concerns and, if we find problems, that we must take the action we believe is appropriate.

We believe our processing period is long enough for all parties to get a fair review of their views. To help speed this

The CHAIRMAN. Thank you, Governor Seger.

Before Chairman Seidman goes ahead, I'm going to ask if Senator D'Amato has a statement.

Senator D'AMATO. Thank you, Mr. Chairman.

Mr. Chairman, it's certainly good to see our distinguished panel and particularly to see our good friend, Dan Wall, who is taking on some incredible battles and we are certainly very proud of the work he's undertaken. It's a very difficult task. Of course, our Comptroller, Mr. Clarke, and my fellow New Yorker, Mr. Seidman. I would ask that a statement that I have accepted as if read in its entirety.

The CHAIRMAN. Without objection, so ordered.

[Statements of Senators Shelby and D'Amato to be inserted in the record:]

process we urge groups to communicate concerns to the applicants and to the Federal Reserve on an ongoing basis, not just when an application is filed.

One procedure that has been used to deal with CRA issues that arise in the context of applications has been to provide a forum for protestants and applicants to sit down together in private meetings and discuss the issues between themselves. Sometimes these meetings have resulted in agreements between the parties. These agreements are essentially private matters. We do not believe the law authorizes us to direct banks to make loans of certain types, with specific terms, in particular amounts, or to specified locations. We believe that lending decisions are best left to the informed judgment of the lender, taking into account the market situation, the lenders own business plans and strengths, and all of the credit demands of its community, which is consistent with the Community Reinvestment Act.

Obviously, a good deal has changed in the financial world since CRA was enacted. Influences such as interstate compacts, changes in technology, and the Monetary Control Act have significantly affected the way business is done. To be sure that we are as responsible as we can be in supplying guidance on our expectations in today's environment, I have asked our staff to review our programs, policies, and procedures, and in particular the 1991 information statement to see where we can

improve our program, provide the necessary guidance and make sure it is up to date.

Nonetheless, I think we have had, and will continue to have, a solid, professional and responsible program in place to deal with CRA. Obviously, we can all improve at what we do. But I believe our program of education, and review of applicants' CRA records, and examinations has been totally consistent with what the law told us we should be doing. I expect to go on trying to improve that program and believe we will thereby help achieve what we all seek--and that is responsible, safe and sound involvement by financial institutions in their communities on a day to day basis.

I appreciate the opportunity to appear before this committee today to discuss this important subject. I will be pleased to take any questions the committee might have.



ATTACHMENT A

- 16 -

Seminars, Workshops and Conferences Sponsored by Reserve Banks  
1985 - 1987

Providence

05/01/85 Roundtable on Consumer Issues  
05/86 Hosted NMS meeting  
05/86 Forum for Providence Bankers on Special Credit Programs featuring Paul Grogan from the Local Initiatives Support Corporation (LISC)  
03/11/86 Community Affairs Seminar in Cranston, RI sponsored by Boston Federal Reserve Bank and Rhode Island Bankers Association

New York

05/10/85 Presentation of Title Lien Data Verification Study to New York State Banking Department and the FDIC  
05/29/85 Roundtable on Consumer Banking Issues attended by representatives in the District.  
09/19/85 Roundtable Discussion of Private Lender Participation in Projects funded by the New York State Low Income Housing Trust Fund Program  
02/13/86 Seminar on "Low Cost Financial Services" attended by lenders (80 attendees)  
03/20/86 Conference on "Accessing New York City Services for Businesses co-sponsored with the City Office of Business Development and the Regional Interagency Committee. Attended by lenders and government representatives (125 participants)  
06/24/86 Seminar on "Mortgage Criteria: Risk Management in Urban Areas" focused on underwriting criteria (90 participants)  
10/20/86 Seminar on Mutual Housing as a New Approach to Long-Term Affordable Housing attended by lenders, government representatives, foundations and community organizations (approximately 140 attendees)

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12/16/86 Briefing on Mehemiah II housing project for lenders and community groups  
04/23/87 Seminar on "Rehabilitation Financing: Case Studies in Producing Housing for Low and Moderate Income People (130 attendees)  
06/25/87 Seminar on "Financing Small Business Development" (120 participants)  
10/22/87 Seminar on "Lending for Community Development: Options" (120 participants)  
12/08/87 Workshop on Low Income Housing Tax Credits for senior lending officials

Philadelphia

06/26/85 Seminar on Consumer Banking for area banks  
03/21/86 Meeting of Council of Community Affairs Officers of Philadelphia banks  
07/30/86 Philadelphia Banks Community Affairs Officers Conference  
03/23/87 Philadelphia Council of Community Affairs Officers  
04/15/87 & 06/26/87 Meetings of Camden Council of Community Affairs Officers  
07/21/87 Community Affairs Conference co-sponsored with Richmond Federal Reserve Bank and the Enterprise Foundation held in Baltimore  
09/24/87 Special meeting of Compliance Officers of Philadelphia banks  
10/02/87 Annual Bank CAO's Conference (150 participants)  
11/19/87 Camden Council of Community Affairs Officers

Cleveland

3rd qtr.' 85 "Private Sector Partnerships for Creative Economic Development" co-sponsored with the OCC, Cleveland Banks, BOHIO, ARI

12/10/85 Community Affairs Conference for Kentucky Bankers co-sponsored with St. Louis Federal Reserve Bank

1st qtr.' 86 Focus group for large BHC's in District to discuss CRA and Community Affairs issues

2nd qtr.' 86 NBS Tenth Anniversary Celebration

2nd qtr.' 86 Meetings with Pittsburgh lenders on Community Development lending co-sponsored with the Pittsburgh Working Group

3rd qtr.' 86 Presentation by CAMDO to local CDC's, lenders, city officials and foundations

3rd qtr.' 86 Seminar on CRA for Cincinnati bankers

11/17/86 CRA Officers Forum for bankers

1st qtr.' 87 Community Affairs Program at Pittsburgh Branch on low-income housing

2nd qtr.' 87 Cincinnati CRA Officers Council co-sponsored with FHLB of Cincinnati

10/87 Conference on Community Partnerships co-sponsored with HUD. Held in Pittsburgh

Richmond

01/16/85 SBA 503 Certified Development Companies meeting co-sponsored with Richmond Renaissance

03/06/85 Advisory Council of Richmond NBS

08/15/85 Home Base Home Ownership Counseling Service seminar for lenders

10/16/85 Community Redevelopment Conference for the Carolinas in Charlotte, N.C. Attended by banks, savings and loans, credit unions and community groups

11/12/85 "Neighborhood Reinvestment and Development in Richmond: A Report." Seminar for bankers and community groups

03/11/86 Conference on "Federal Financing and Management Assistance for Small Business Exporters" Co-sponsored with SBA at the Baltimore branch

07/17/86 Conference on "Neighborhood Reinvestment in D.C. - A Partnership of Housing Concerns and Banking"

02/19/87 Conference on "Commercial Revitalization Loan Programs" Co-sponsored with the Virginia Downtown Development Association and the Virginia Department of Housing and Community Development

07/21/87 Community Affairs Conference co-sponsored with Philadelphia Federal Reserve and the Enterprise Foundation at the Baltimore branch

08/20/87 Workshop on the Virginia Main Street Program (50 attendees)

10/28/87 CRA Conference in Columbia, S.C.

Atlanta

03/18/85 Workshop on "Successful Strategic Planning for Alabama Communities" (150 participants)

12/85 Conference on "The Role of Banks in Local Economic Development" in New Orleans for bankers in Louisiana and Mississippi (over 100 attendees)

02/87 Conference on "The Entrepreneurial American City" in Tampa co-sponsored with HUD (over 300 participants)

Chicago

05/14/85 Conference on Community Development Corporations for lenders in Illinois

09/23/85 Conference on Community Development Corporations for lenders in Michigan

2nd qtr.' 86 Conference on Community Development Corporations for lenders in Indiana

05/18/87 Conference on Community Development Corporations for lenders in Wisconsin

09/87 Conference on "Financial Institutions and Local Economic Development" Co-sponsored with the National Council for Urban Economic Development (over 200 participants)

St. Louis

4th qtr.' 85 Seminar on "The Economy - The Impact of Growth on St. Louis"

12/10/85 Community Affairs Forum for bankers in Kentucky co-sponsored with Cleveland Federal Reserve Bank

03/19/87 CRA Seminar for bankers in Kentucky co-sponsored by Cleveland Federal Reserve Bank

04/13/87 NHE Owner - Rehab Project video premiere

05/21/87 Conference on Agricultural and Rural Development

Minneapolis

01/31/85 Conference on "Preserving Access to Financial Services"

2nd qtr.' 85 Networking Opportunity Program for the Metropolitan Economic Development Association (minority business association) and lenders

3rd qtr.' 85 Lenders briefing for the Minneapolis Multi-Family Renovation Project

4th qtr.' 85 Workshop on the Community Information Exchange (CIE) for non-profit developers

1st qtr.' 87 Conference on "Social Investment in Community Development" co-sponsored with the Humphrey Institute of Public Affairs

1st qtr.' 87 Conference on "Working Together for Creative Enterprise" co-sponsored with First Bank Duluth and the Duluth Reinvestment Coalition

4th qtr.' 87 Workshop with the Metropolitan Economic Development Association for minority small business persons

KANSAS CITY

02/25/87 Seminar on Community Development Corporations co-sponsored with the Kansas City Neighborhood Alliance

2nd qtr.' 87 Conference on Community Development Corporations in Milwaukee, Wisconsin co-sponsored with Chicago Federal Reserve Bank

DALLAS

2nd qtr.' 85 Seminar on NHE for lenders

10/10/85 Seminar for lenders on NHE

10/30/85 Workshop for minority and women business persons on lending issues and concerns

04/21/87 Informational seminar for lenders in the district on CRA, Protests and Applications

10/07/87 Seminar for lenders with speakers from the Community Bankers Association

11/05/88 Northwest Texas Rural and Economic Development Conference in Lubbock co-sponsored with SBA and Texas Tech University

SAN FRANCISCO

04/85 Hosted Forums for the Northern California Association for Non-Profit Housing and the Bay Area Council

10/17/85 Community Affairs Conference for lenders, community groups and government representatives (attended by 150)

11/30/85 Forum on Housing Production for housing professionals and others

1st qtr. '86 Hosted Housing Forums on Rent Control, Tax Reform and Affordable Housing for the Northern California Association for Non-Profit Housing

04/23/86 Forum on "The Impact of Financial Service Deregulation on Community Investment"

07/09/86 Hosted Forum on "Software for Real Estate and Housing" for the Northern California Association for Non-Profit Housing

12/86 Hosted Housing Forums on Rehabilitation and Affordable Housing for the Northern California Association for Non-Profit Housing

11/21/86 Seminar on "Access to Housing: Second units in San Francisco" with Independent Housing Services

4th qtr. '87 Hosted Housing Forums for the Northern California Association for Non-Profit Housing

BOARD of GOVERNORS

04/85 Seminar on Basic Banking and Consumer Services attended by consumer group representatives (12 participants)

12/86 Conference on Government Check Cashing and Alternative Benefits Delivery Systems (25 participants)

08/87 Forum on "Financial Institutions' Community Development Corporations" cosponsored with the Office of the Comptroller of the Currency (over 200 participants)

10/87 Conference on "Basic Banking and Home Equity Lines" cosponsored with the American Bankers Association and the Consumer Bankers Association (100 participants)

Formal Talks Given by the Reserve System Community Affairs Offices During 1987

|               |    |                |   |
|---------------|----|----------------|---|
| Boston:       | 1  | Chicago:       | 9 |
| New York:     | 7  | Minneapolis:   | 2 |
| Philadelphia: | 10 | St. Louis:     | 5 |
| Cleveland:    | 7  | Kansas City:   | 2 |
| Richmond:     | 6  | Dallas:        | 8 |
| Atlanta:      | 5  | San Francisco: | 3 |

Board of Governors: 28

Total: 101

- 24 -

|                         | 1986 | 1987 |
|-------------------------|------|------|
| 1. <i>Chrysomelids</i>  | 10   | 10   |
| 2. <i>Curculionids</i>  | 10   | 10   |
| 3. <i>Chrysomelids</i>  | 10   | 10   |
| 4. <i>Curculionids</i>  | 10   | 10   |
| 5. <i>Chrysomelids</i>  | 10   | 10   |
| 6. <i>Curculionids</i>  | 10   | 10   |
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| 33. <i>Chrysomelids</i> | 10   | 10   |
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| 80. <i>Curculionids</i> | 10   | 10   |
| 81. <i>Chrysomelids</i> | 10   | 10   |
| 82. <i>Curculionids</i> | 10   | 10   |
| 83. <i>Chrysomelids</i> | 10   | 10   |
| 84. <i>Curculionids</i> | 10   | 10   |
| 85. <i>Chrysomelids</i> | 10   | 10   |
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| 87. <i>Chrysomelids</i> | 10   | 10   |
| 88. <i>Curculionids</i> | 10   | 10   |
| 89. <i>Chrysomelids</i> | 10   | 10   |
| 90. <i>Curculionids</i> | 10   | 10   |
| 91. <i>Chrysomelids</i> | 10   | 10   |
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| 93. <i>Chrysomelids</i> | 10   | 10   |
| 94. <i>Curculionids</i> | 10   | 10   |
| 95. <i>Chrysomelids</i> | 10   | 10   |
| 96. <i>Curculionids</i> | 10   | 10   |
| 97. <i>Chrysomelids</i> | 10   | 10   |
| 98. <i>Curculionids</i> | 10   |      |

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|-----------------------------------------------------------------------------------------------------------------|------------|------------|
| Government Officials<br>(including state and local)                                                             | 214        | 247        |
| Civil Rights and Consumer<br>Organisations<br>(including legal services)                                        | 14         | 9          |
| Community Development Corpor-<br>ations<br>(including Economic Develop-<br>ment and Housing Organisa-<br>tions) | 161        | 163        |
| Grass Roots Community Groups                                                                                    | 52         | 42         |
| Trade Associations                                                                                              | 157        | 120        |
| Private Individuals                                                                                             | 186        | 216        |
| <b>TOTAL</b>                                                                                                    | <b>787</b> | <b>787</b> |

\* Community contacts reported by Federal Reserve Bank personnel, primarily in the context of Community Reinvestment Act examinations, either in person or by telephone.

| CITY |  | 1987 | 1988 | 1989 | 1990 | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2034 | 2035 | 2036 | 2037 | 2038 | 2039 | 2040 | 2041 | 2042 | 2043 | 2044 | 2045 | 2046 | 2047 | 2048 | 2049 | 2050 | 2051 | 2052 | 2053 | 2054 | 2055 | 2056 | 2057 | 2058 | 2059 | 2060 | 2061 | 2062 | 2063 | 2064 | 2065 | 2066 | 2067 | 2068 | 2069 | 2070 | 2071 | 2072 | 2073 | 2074 | 2075 | 2076 | 2077 | 2078 | 2079 | 2080 | 2081 | 2082 | 2083 | 2084 | 2085 | 2086 | 2087 | 2088 | 2089 | 2090 | 2091 | 2092 | 2093 | 2094 | 2095 | 2096 | 2097 | 2098 | 2099 | 2100 | 2101 | 2102 | 2103 | 2104 | 2105 | 2106 | 2107 | 2108 | 2109 | 2110 | 2111 | 2112 | 2113 | 2114 | 2115 | 2116 | 2117 | 2118 | 2119 | 2120 | 2121 | 2122 | 2123 | 2124 | 2125 | 2126 | 2127 | 2128 | 2129 | 2130 | 2131 | 2132 | 2133 | 2134 | 2135 | 2136 | 2137 | 2138 | 2139 | 2140 | 2141 | 2142 | 2143 | 2144 | 2145 | 2146 | 2147 | 2148 | 2149 | 2150 | 2151 | 2152 | 2153 | 2154 | 2155 | 2156 | 2157 | 2158 | 2159 | 2160 | 2161 | 2162 | 2163 | 2164 | 2165 | 2166 | 2167 | 2168 | 2169 | 2170 | 2171 | 2172 | 2173 | 2174 | 2175 | 2176 | 2177 | 2178 | 2179 | 2180 | 2181 | 2182 | 2183 | 2184 | 2185 | 2186 | 2187 | 2188 | 2189 | 2190 | 2191 | 2192 | 2193 | 2194 | 2195 | 2196 | 2197 | 2198 | 2199 | 2200 | 2201 | 2202 | 2203 | 2204 | 2205 | 2206 | 2207 | 2208 | 2209 | 2210 | 2211 | 2212 | 2213 | 2214 | 2215 | 2216 | 2217 | 2218 | 2219 | 2220 | 2221 | 2222 | 2223 | 2224 | 2225 | 2226 | 2227 | 2228 | 2229 | 2230 | 2231 | 2232 | 2233 | 2234 | 2235 | 2236 | 2237 | 2238 | 2239 | 2240 | 2241 | 2242 | 2243 | 2244 | 2245 | 2246 | 2247 | 2248 | 2249 | 2250 | 2251 | 2252 | 2253 | 2254 | 2255 | 2256 | 2257 | 2258 | 2259 | 2260 | 2261 | 2262 | 2263 | 2264 | 2265 | 2266 | 2267 | 2268 | 2269 | 2270 | 2271 | 2272 | 2273 | 2274 | 2275 | 2276 | 2277 | 2278 | 2279 | 2280 | 2281 | 2282 | 2283 | 2284 | 2285 | 2286 | 2287 | 2288 | 2289 | 2290 | 2291 | 2292 | 2293 | 2294 | 2295 | 2296 | 2297 | 2298 | 2299 | 2300 | 2301 | 2302 | 2303 | 2304 | 2305 | 2306 | 2307 | 2308 | 2309 | 2310 | 2311 | 2312 | 2313 | 2314 | 2315 | 2316 | 2317 | 2318 | 2319 | 2320 | 2321 | 2322 | 2323 | 2324 | 2325 | 2326 | 2327 | 2328 | 2329 | 2330 | 2331 | 2332 | 2333 | 2334 | 2335 | 2336 | 2337 | 2338 | 2339 | 2340 | 2341 | 2342 | 2343 | 2344 | 2345 | 2346 | 2347 | 2348 | 2349 | 2350 | 2351 | 2352 | 2353 | 2354 | 2355 | 2356 | 2357 | 2358 | 2359 | 2360 | 2361 | 2362 | 2363 | 2364 | 2365 | 2366 | 2367 | 2368 | 2369 | 2370 | 2371 | 2372 | 2373 | 2374 | 2375 | 2376 | 2377 | 2378 | 2379 | 2380 | 2381 | 2382 | 2383 | 2384 | 2385 | 2386 | 2387 | 2388 | 2389 | 2390 | 2391 | 2392 | 2393 | 2394 | 2395 | 2396 | 2397 | 2398 | 2399 | 2400 | 2401 | 2402 | 2403 | 2404 | 2405 | 2406 | 2407 | 2408 | 2409 | 2410 | 2411 | 2412 | 2413 | 2414 | 2415 | 2416 | 2417 | 2418 | 2419 | 2420 | 2421 | 2422 | 2423 | 2424 | 2425 | 2426 | 2427 | 2428 | 2429 | 2430 | 2431 | 2432 | 2433 | 2434 | 2435 | 2436 | 2437 | 2438 | 2439 | 2440 | 2441 | 2442 | 2443 | 2444 | 2445 | 2446 | 2447 | 2448 | 2449 | 2450 | 2451 | 2452 | 2453 | 2454 | 2455 | 2456 | 2457 | 2458 | 2459 | 2460 | 2461 | 2462 | 2463 | 2464 | 2465 | 2466 | 2467 | 2468 | 2469 | 2470 | 2471 | 2472 | 2473 | 2474 | 2475 | 2476 | 2477 | 2478 | 2479 | 2480 | 2481 | 2482 | 2483 | 2484 | 2485 | 2486 | 2487 | 2488 | 2489 | 2490 | 2491 | 2492 | 2493 | 2494 | 2495 | 2496 | 2497 | 2498 | 2499 | 2500 | 2501 | 2502 | 2503 | 2504 | 2505 | 2506 | 2507 | 2508 | 2509 | 2510 | 2511 | 2512 | 2513 | 2514 | 2515 | 2516 | 2517 | 2518 | 2519 | 2520 | 2521 | 2522 | 2523 | 2524 | 2525 | 2526 | 2527 | 2528 | 2529 | 2530 | 2531 | 2532 | 2533 | 2534 | 2535 | 2536 | 2537 | 2538 | 2539 | 2540 | 2541 | 2542 | 2543 | 2544 | 2545 | 2546 | 2547 | 2548 | 2549 | 2550 | 2551 | 2552 | 2553 | 2554 | 2555 | 2556 | 2557 | 2558 | 2559 | 2560 | 2561 | 2562 | 2563 | 2564 | 2565 | 2566 | 2567 | 2568 | 2569 | 2570 | 2571 | 2572 | 2573 | 2574 | 2575 | 2576 | 2577 | 2578 | 2579 | 2580 | 2581 | 2582 | 2583 | 2584 | 2585 | 2586 | 2587 | 2588 | 2589 | 2590 | 2591 | 2592 | 2593 | 2594 | 2595 | 2596 | 2597 | 2598 | 2599 | 2600 | 2601 | 2602 | 2603 | 2604 | 2605 | 2606 | 2607 | 2608 | 2609 | 2610 | 2611 | 2612 | 2613 | 2614 | 2615 | 2616 | 2617 | 2618 | 2619 | 2620 | 2621 | 2622 | 2623 | 2624 | 2625 | 2626 | 2627 | 2628 | 2629 | 2630 | 2631 | 2632 | 2633 | 2634 | 2635 | 2636 | 2637 | 2638 | 2639 | 2640 | 2641 | 2642 | 2643 | 2644 | 2645 | 2646 | 2647 | 2648 | 2649 | 2650 | 2651 | 2652 | 2653 | 2654 | 2655 | 2656 | 2657 | 2658 | 2659 | 2660 | 2661 | 2662 | 2663 | 2664 | 2665 | 2666 | 2667 | 2668 | 2669 | 2670 | 2671 | 2672 | 2673 | 2674 | 2675 | 2676 | 2677 | 2678 | 2679 | 2680 | 2681 | 2682 | 2683 | 2684 | 2685 | 2686 | 2687 | 2688 | 2689 | 2690 | 2691 | 2692 | 2693 | 2694 | 2695 | 2696 | 2697 | 2698 | 2699 | 2700 | 2701 | 2702 | 2703 | 2704 | 2705 | 2706 | 2707 | 2708 | 2709 | 2710 | 2711 | 2712 | 2713 | 2714 | 2715 | 2716 | 2717 | 2718 | 2719 | 2720 | 2721 | 2722 | 2723 | 2724 | 2725 | 2726 | 2727 | 2728 | 2729 | 2730 | 2731 | 2732 | 2733 | 2734 | 2735 | 2736 | 2737 | 2738 | 2739 | 2740 | 2741 | 2742 | 2743 | 2744 | 2745 | 2746 | 2747 | 2748 | 2749 | 2750 | 2751 | 2752 | 2753 | 2754 | 2755 | 2756 | 2757 | 2758 | 2759 | 2760 | 2761 | 2762 | 2763 | 2764 | 2765 | 2766 | 2767 | 2768 | 2769 | 2770 | 2771 | 2772 | 2773 | 2774 | 2775 | 2776 | 2777 | 2778 | 2779 | 2780 | 2781 | 2782 | 2783 | 2784 | 2785 | 2786 | 2787 | 2788 | 2789 | 2790 | 2791 | 2792 | 2793 | 2794 | 2795 | 2796 | 2797 | 2798 | 2799 | 2800 | 2801 | 2802 | 2803 | 2804 | 2805 | 2806 | 2807 | 2808 | 2809 | 2810 | 2811 | 2812 | 2813 | 2814 | 2815 | 2816 | 2817 | 2818 | 2819 | 2820 | 2821 | 2822 | 2823 | 2824 | 2825 | 2826 | 2827 | 2828 | 2829 | 2830 | 2831 | 2832 | 2833 | 2834 | 2835 | 2836 | 2837 | 2838 | 2839 | 2840 | 2841 | 2842 | 2843 | 2844 | 2845 | 2846 | 2847 | 2848 | 2849 | 2850 | 2851 | 2852 | 2853 | 2854 | 2855 | 2856 | 2857 | 2858 | 2859 | 2860 | 2861 | 2862 | 2863 | 2864 | 2865 | 2866 | 2867 | 2868 | 2869 | 2870 | 2871 | 2872 | 2873 | 2874 | 2875 | 2876 | 2877 | 2878 | 2879 | 2880 | 2881 | 2882 | 2883 | 2884 | 2885 | 2886 | 2887 | 2888 | 2889 | 2890 | 2891 | 2892 | 2893 | 2894 | 2895 | 2896 | 2897 | 2898 | 2899 | 2900 | 2901 | 2902 | 2903 | 2904 | 2905 | 2906 | 2907 | 2908 | 2909 | 2910 | 2911 | 2912 | 2913 | 2914 | 2915 | 2916 | 2917 | 2918 | 2919 | 2920 | 2921 | 2922 | 2923 | 2924 | 2925 | 2926 | 2927 | 2928 | 2929 | 2930 | 2931 | 2932 | 2933 | 2934 | 2935 | 2936 | 2937 | 2938 | 2939 | 2940 | 2941 | 2942 | 2943 | 2944 | 2945 | 2946 | 2947 | 2948 | 2949 | 2950 | 2951 | 2952 | 2953 | 2954 | 2955 | 2956 | 2957 | 2958 | 2959 | 2960 | 2961 | 2962 | 2963 | 2964 | 2965 | 2966 | 2967 | 2968 | 2969 | 2970 | 2971 | 2972 | 2973 | 2974 | 2975 | 2976 | 2977 | 2978 | 2979 | 2980 | 2981 | 2982 | 2983 | 2984 | 2985 | 2986 | 2987 | 2988 | 2989 | 2990 | 2991 | 2992 | 2993 | 2994 | 2995 | 2996 | 2997 | 2998 | 2999 | 3000 | 3001 | 3002 | 3003 | 3004 | 3005 | 3006 | 3007 | 3008 | 3009 | 3010 | 3011 | 3012 | 3013 | 3014 | 3015 | 3016 | 3017 | 3018 | 3019 | 3020 | 3021 | 3022 | 3023 | 3024 | 3025 | 3026 | 3027 | 3028 | 3029 | 3030 | 3031 | 3032 | 3033 | 3034 | 3035 | 3036 | 3037 | 3038 | 3039 | 3040 | 3041 | 3042 | 3043 | 3044 | 3045 | 3046 | 3047 | 3048 | 3049 | 3050 | 3051 | 3052 | 3053 | 3054 | 3055 | 3056 | 3057 | 3058 | 3059 | 3060 | 3061 | 3062 | 3063 | 3064 | 3065 | 3066 | 3067 | 3068 | 3069 | 3070 | 3071 | 3072 | 3073 | 3074 | 3075 | 3076 | 3077 | 3078 | 3079 | 3080 | 3081 | 3082 | 3083 | 3084 | 3085 | 3086 | 3087 | 3088 | 3089 | 3090 | 3091 | 3092 | 3093 | 3094 | 3095 | 3096 | 3097 | 3098 | 3099 | 3100 | 3101 | 3102 | 3103 | 3104 | 3105 | 3106 | 3107 | 3108 | 3109 | 3110 | 3111 | 3112 | 3113 | 3114 | 3115 | 3116 | 3117 | 3118 | 3119 | 3120 | 3121 | 3122 | 3123 | 3124 | 3125 | 3126 | 3127 | 3128 | 3129 | 3130 | 3131 | 3132 | 3133 | 3134 | 3135 | 3136 | 3137 | 3138 | 3139 | 3140 | 3141 | 3142 | 3143 | 3144 | 3145 | 3146 | 3147 | 3148 | 3149 | 3150 | 3151 | 3152 | 3153 | 3154 | 3155 | 3156 | 3157 | 3158 | 3159 | 3160 | 3161 | 3162 | 3163 | 3164 | 3165 | 3166 | 3167 | 3168 | 3169 | 3170 | 3171 | 3172 | 3173 | 3174 | 3175 | 3176 | 3177 | 3178 | 3179 | 3180 | 3181 | 3182 | 3183 | 3184 | 3185 | 3186 | 3187 | 3188 | 3189 | 3190 | 3191 | 3192 | 3193 | 3194 | 3195 | 3196 | 3197 | 3198 | 3199 | 3200 | 3201 | 3202 | 3203 | 3204 | 3205 | 3206 | 3207 | 3208 | 3209 | 3210 | 3211 | 3212 | 3213 | 3214 | 3215 | 3216 | 3217 | 3218 | 3219 | 3220 | 3221 | 3222 | 3223 | 3224 | 3225 | 3226 | 3227 | 3228 | 3229 | 3230 | 3231 | 3232 | 3233 | 3234 | 3235 | 3236 | 3237 | 3238 | 3239 | 3240 | 3241 | 3242 | 3243 | 3244 | 3245 | 3246 | 3247 | 3248 | 3249 | 3250 | 3251 | 3252 | 3253 | 3254 | 3255 | 3256 | 3257 | 3258 | 3259 | 3260 | 3261 | 3262 | 3263 | 3264 | 3265 | 3266 | 3267 | 3268 | 3269 | 3270 | 3271 | 3272 | 3273 | 3274 | 3275 | 3276 | 3277 | 3278 | 3279 | 3280 | 3281 | 3282 | 3283 | 3284 | 3285 | 3286 | 3287 | 3288 | 3289 | 3290 | 3291 | 3292 | 3293 | 3294 | 3295 | 3296 | 3297 | 3298 | 3299 | 3300 | 3301 | 3302 | 3303 | 3304 | 3305 | 3306 | 3307 | 3308 | 3309 | 3310 | 3311 | 3312 | 3313 | 3314 | 3315 | 3316 | 3317 | 3318 | 3319 | 3320 | 3321 | 3322 | 3323 | 3324 | 3325 | 3326 | 3327 | 3328 | 3329 | 3330 | 3331 | 3332 | 3333 | 3334 | 3335 | 3336 | 3337 | 3338 | 3339 | 3340 | 3341 | 3342 | 3343 | 3344 | 3345 | 3346 | 3347 | 3348 | 3349 | 3350 | 3351 | 3352 | 3353 | 3354 | 3355 | 3356 | 3357 | 3358 | 3359 | 3360 | 33 |
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## STATEMENT BY SENATOR RICHARD SHELBY

MARCH 25, 1988

## COMMUNITY REINVESTMENT ACT

MR. CHAIRMAN, I COMMEND YOU FOR CALLING A HEARING ON THIS TENTH ANNIVERSARY OF THE COMMUNITY REINVESTMENT ACT. IT'S TIME TO REVISIT THIS LAW AND SEE WHETHER IT HAS HAD THE IMPACT THAT WAS INTENDED UPON ITS ENACTMENT.

YESTERDAY'S TESTIMONY DISCLOSED SOME INTERESTING FACTS. IN THE OPINION OF THE BANK REGULATORS, OUR BANKS ARE DOING A SUPERLATIVE JOB IN MEETING CRA REQUIREMENTS. AROUND 99% OF LENDING INSTITUTIONS HAVE A PASSING GRADE WHEN IT COMES TO CRA. ONLY 8 OF THE 40,000 APPLICATIONS MADE BY FINANCIAL INSTITUTIONS IN THE PAST TEN YEARS HAVE BEEN DENIED ON THE BASIS OF CRA.

THERE WERE OTHER INTERESTING FACTS DISCLOSED IN YESTERDAY'S TESTIMONY. ACORN (ASSOCIATION OF COMMUNITY ORGANIZATIONS FOR REFORM NOW) PROVIDED AN EXAMPLE OF DISCRIMINATORY LENDING PRACTICES THAT BELIE THE PREVIOUS STATISTICS. ONE NEW ORLEANS BANK, WHICH RECEIVED THE BULK OF DEPOSITS IN ONE BRANCH FROM THE LOWER INCOME NEIGHBORHOOD WHICH SURROUNDED IT, LOANED BACK TO THAT COMMUNITY ONLY ONE PERCENT OF THESE DEPOSITS. ACORN CALLED THIS BANK A GIANT VACUUM CLEANER THAT SUCKED MONEY FROM THE POOR AND LOANED IT TO THE RICH. I THINK THAT SOUNDS LIKE AN ACCURATE DESCRIPTION.

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I WOULD NOT SUPPORT EFFORTS TO MANDATE THAT BANKS MAKE HIGH RISK, LOW COST LOANS. BANKS ARE BUSINESSES, NOT CHARITABLE ORGANIZATIONS. BUT EVERY WITNESS THUS FAR HAS TESTIFIED THAT LOANS MADE TO LOWER INCOME CLIENTS HAVE PERFORMED BETTER THAN THEIR LOAN PORTFOLIO AVERAGE. CITIZENS TRUST BANK IN ATLANTA HAS THE BEST CRA LENDING RECORD AND THE LOWEST RATE OF NONPERFORMING LOANS. I DO NOT BELIEVE THAT CRA REQUIREMENTS REPRESENT AN UNREASONABLE HARDSHIP ON BANKS. BANKS DO HAVE AN OBLIGATION HAS THE "ECONOMIC ENGINE OF THE COMMUNITY." I WANT US TO SEE THAT BANKS MEET THEIR OBLIGATION.

YESTERDAY'S WITNESSES WERE ASKED BY THE CHAIRMAN TO RATE THE REGULATORS. WITH THE EXCEPTION OF THE CHICAGO FEDERAL RESERVE BANK, REGULATORS WERE GIVEN AN F. THE OFFICE OF THE COMPTROLLER OF THE CURRENCY WAS CITED AS DOING A GOOD PR JOB BUT DOING LITTLE IN SUBSTANCE.

I WANT TO SEE THAT REGULATORS ENFORCE CRA. I CANNOT BELIEVE THAT 96-99% OF OUR NATION'S FINANCIAL INSTITUTIONS DESERVE A PASSING GRADE. IF WE MUST, WE CAN LEGISLATE TO PUT SOME TEETH IN CRA.

I WELCOME HEARING YOUR SIDE OF THE STORY TODAY.

STATEMENT OF SENATOR D'AMATO  
COMMUNITY REINVESTMENT ACT  
MARCH 23, 1988

MR CHAIRMAN, I AM PLEASED TO PARTICIPATE IN THIS HEARING ADDRESSING THE ENFORCEMENT OF THE COMMUNITY REINVESTMENT ACT. COMMUNITY ORGANIZATIONS, IN PARTICULAR, HAVE A STRONG INTEREST IN THE ENFORCEMENT OF THIS LEGISLATION. I COMMEND SENATOR PROXMIRE FOR HIS COMMITMENT TO COMMUNITY DEVELOPMENT AND REVITALIZATION.

THE COMMUNITY REINVESTMENT ACT OF 1977 REAFFIRMS THE RESPONSIBILITY OF FINANCIAL INSTITUTIONS TO MEET THE NEEDS OF THE COMMUNITIES IN WHICH THEY ARE LOCATED. SPECIFICALLY, THE ACT REQUIRES FEDERAL REGULATORS TO TAKE INTO ACCOUNT THE COMMUNITY REINVESTMENT RECORD OF BANKS AND THRIFTS WHEN THOSE INSTITUTIONS APPLY FOR CHANGES, LIKE MERGERS AND BRANCHING. UNDER THE LAW, COMMUNITY GROUPS HAVE THE RIGHT TO CHALLENGE THE APPLICATIONS IF IT IS BELIEVED THAT THE FINANCIAL INSTITUTION VIOLATES THE COMMUNITY REINVESTMENT ACT.

NUMEROUS COMMUNITY GROUPS HAVE EXPRESSED A GREAT DEAL OF DISMAY OVER THE ENFORCEMENT, OR NON-ENFORCEMENT, OF THE ACT. THESE GROUPS CLAIM THAT REGULATORS ARE NOT TAKING INTO ACCOUNT THE COMMUNITY REINVESTMENT RECORD OF A FINANCIAL INSTITUTION WHEN IT APPLIES TO MAKE CHANGES. MANY OF THESE

I AM AWARE THAT MY COLLEAGUES ON THE HOUSE BANKING COMMITTEE ARE DRAFTING LEGISLATION TO RESPOND TO THESE ALLEGATIONS AND, SPECIFICALLY, TO PROTECT CONSUMERS FROM LENDERS WHICH HAVE OVERLOOKED THEIR COMMITMENT TO THE COMMUNITY.

THE COMMUNITY REINVESTMENT ACT WAS ADOPTED TO INSURE THAT CERTAIN LENDING INSTITUTIONS DO NOT ABANDON LOW-TO-MODERATE-INCOME CONSUMERS FOR THE BUSINESS OF THE AFFLUENT. I FULLY SUPPORT THIS GOAL AND I AM PLEASED TO REASSESS THE EFFECTIVENESS OF THIS LEGISLATION. I ASSURE BOTH OUR WITNESSES AND MY COLLEAGUES THAT THE MATTERS BEING DISCUSSED HERE WILL RECEIVE MY CLOSE AND CONTINUING ATTENTION. THIS LAW MUST BE ENFORCED.

THANK YOU, MR. CHAIRMAN.

Senator D'AMATO. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Bond, do you have a statement you would like to make?

Senator BOND. Thank you, Mr. Chairman. I would merely join with you and the others of the committee in welcoming our distinguished regulators. We note that Mr. Wall seems to have survived in the new role after his years of helping provide guidance to the administrative side of Government. I hope that he finds that advice continues to be useful. We are most interested in hearing the presentations today. Thank you, sir.

The CHAIRMAN. Thank you very much.

Chairman Seidman, go ahead, sir.

#### STATEMENT OF L. WILLIAM SEIDMAN, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. SEIDMAN. Thank you, Mr. Chairman.

I'm pleased to be here today to present the views of the FDIC on the enforcement of the Community Reinvestment Act.

The CRA requires the FDIC to encourage State-chartered non-member banks to help meet local community credit needs consistent with safe and sound operations of those banks. Since enactment of this important law in 1977, the FDIC has worked hard to enforce the CRA mandate and to assist banks in meeting their requirements under that law.

The FDIC performs its role under the CRA primarily through effective bank supervision and enforcement. Monitoring and enforcing bank compliance with the CRA mandate is critical in the FDIC's evaluation of bank applications for deposit insurance, to establish a branch, to relocate a home office or a branch, to merge, and in other instances.

We have found that banks generally comply with the CRA requirements. Our most recent statistics indicate that about 98 percent of all FDIC-supervised banks examined for CRA compliance had satisfactory ratings. It should be emphasized that a CRA rating is an assessment of a bank's performance record over time, not isolated cases of technical noncompliance.

Because of the dramatic increase in the number of failed and problem banks in recent years, the FDIC has had to devote significant increased resources to problems involving safety and soundness. Therefore, our bank consumer compliance effort has not been as comprehensive as it should be.

Beginning in 1986, we moved to correct this problem by allocating additional resources to this area. In 1987, we increased our compliance examination activity considerably, nearly doubling the number of examinations conducted in 1986. Under the budget approved recently by the FDIC board of directors, the number of compliance examinations during 1988 is projected to increase again by approximately 60 percent.

We improved the FDIC CRA program by restructuring our Office of Consumer Affairs in early 1987. That office is now an independent component of the FDIC and its director, who is with me here today, reports directly to my office as chairman.



The Office of Consumer Affairs reviews all CRA-related protests filed against an FDIC-supervised bank and makes written recommendations to our Division of Bank Supervision regarding the disposition of those protests.

The FDIC has also increased CRA training for both FDIC employees and bankers. The bulk of compliance training of FDIC employees, including CRA training, is conducted on-site by senior field examiners. The FDIC's Division of Bank Supervision administers our corporation's consumer protection school. In 1988, we plan to increase our class participation by over 100 percent. A 2-hour review of consumer protection law is included in all advanced training for assistant examiners and the Office of Consumer Affairs conducts a 2½-day compliance seminar annually for regional examiners.

In order to better assist banks in understanding and complying with CRA, we plan to hold a number of 1-day compliance seminars for banks in various parts of the country. We are also considering conducting a compliance teleconference via satellite for banks similar to our successful call report satellite conference project. The primary focus of this effort will be to help banks develop, document and monitor their consumer compliance programs.

We are conducting meetings with several community and consumer protection and civil rights organizations. At those meetings we exchange views on community reinvestment and other consumer and community related issues.

We have also attempted to handle a record number of bank failures in such a way that community services continue. We have been successful in achieving this goal in the great majority of cases.

In summary, since 1986, we have made many improvements in carrying out our CRA responsibilities and we have a number of other actions we will be taking in this regard.

We believe the current system is working well, but even so, we can and will improve our performance. With all due deference to the marks given us by the previous groups that have appeared before this committee, while we may not be an A, we are certainly not an F; and we intend to be an A in the future.

Thank you once again, Mr. Chairman and members of the committee, for giving us an opportunity to express our views on an issue of special importance to the Nation's communities and its financial system. I'd be pleased to answer any questions.

[The complete prepared statement of L. William Seidman follows:]

TESTIMONY OF

L. WILLIAM SEIDMAN  
CHAIRMAN  
FEDERAL DEPOSIT INSURANCE CORPORATION  
WASHINGTON, D.C.

ON

THE COMMUNITY REINVESTMENT ACT

BEFORE THE

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
UNITED STATES SENATE

10:00 a.m.  
Wednesday, March 23, 1988  
Dirksen Senate Office Building

Good morning, Mr. Chairman and members of the Committee. I am pleased to be here today to present the views of the Federal Deposit Insurance Corporation on enforcement of the Community Reinvestment Act (CRA). Attached are detailed answers to the questions contained in your recent letters on this subject.

Introduction

Since enactment of this important law in 1977, the FDIC has worked hard to enforce the CRA mandate. That mandate requires us to encourage State chartered, nonmember banks to help meet local community credit needs, including those of low- and moderate-income neighborhood residents, consistent with the safe and sound operation of those banks.

In carrying out its responsibilities under the CRA, the FDIC realizes the importance of the availability of residential mortgage credit and home improvement and rehabilitation loans in preventing the decline of neighborhoods, communities and entire cities. We also are mindful of the value of community reinvestment by banks in making small business loans and loans for community development and redevelopment projects and programs. Such lending efforts help build the physical, social and economic fabric of our nation's neighborhoods and cities and, thus, improve the quality of life for people in our nation's neighborhoods and communities.

The FDIC views the CRA as an integral part of the comprehensive network of fair lending laws that includes the Fair Housing Act, the Equal Credit Opportunity Act, and the Home Mortgage Disclosure Act. This agency works diligently to enforce the objectives of all federal fair lending statutes for which it has enforcement responsibility. We view the effective enforcement of every fair lending law within our jurisdiction as necessary, not only to assure that our statutory mandates are being met, but also to strengthen consumer confidence and trust in the banks supervised by the FDIC.

The FDIC's Role Under the CRA

The fundamental role of the federal financial regulators under the CRA is to encourage the institutions we supervise to help meet local community credit needs, consistent with safe and sound banking practices. The FDIC performs its role primarily through effective bank supervision and enforcement. We administer a compliance examination program by which FDIC-supervised banks are regularly examined, evaluated and rated as to compliance with fair lending laws, including the CRA. This program is carried out according to comprehensive, specific and detailed examination procedures used by each of the federal financial regulators.

In order to enforce compliance with the CRA, in 1978 the FDIC adopted Part 345 of its regulations and comprehensive CRA examination procedures. The major measures of effectiveness in CRA compliance are the assessment factors outlined in our CRA regulations. After applying those factors, the FDIC rates banks in accordance with the Uniform Interagency CRA Assessment Rating System.

The ratings range from 1 to 5, with one being the best. We give special supervisory attention to banks with compliance and CRA ratings of "3," "4," and "5."

In the CRA examination process, examiners evaluate banks on a case-by-case basis taking into account their size, expertise and locale. Community credit needs often differ based on the characteristics of each local community. Banks are evaluated on the basis of efforts to ascertain, determine and help meet community credit needs in the context of local circumstances and resources. FDIC examiners also discuss their findings regarding the bank's CRA performance with bank management. Examiners provide appropriate CRA-related information and technical assistance at that time, thereby helping banks to understand the purposes of the CRA and the FDIC's enforcement role.

Monitoring and enforcing bank compliance with the CRA mandate is critical in the FDIC's evaluation of bank applications for deposit insurance, to establish a branch, to relocate a home office or branch, to merge and in other specified instances. In making decisions on such applications, the FDIC gives due consideration to the bank's CRA performance record. This is required in all cases, not merely in instances where a protest has been filed. As a result of these evaluations, CRA-related violations have resulted in remedial corrective advisements, memoranda of understanding and delayed or conditional approval of applications, as well as application denials.

In addition to enforcing the CRA as part of the examination process and in the context of individual applications, our Office of Consumer Affairs (OCA)

coordinates the processing of CRA complaints filed against banks. Such complaints are investigated by the FDIC or referred to the appropriate federal financial regulator for handling.

All in all, we at the FDIC believe our CRA enforcement efforts have been effective. This view is based on the large number of banks which receive a satisfactory or higher CRA rating, the low number of CRA consumer complaints or protests we have received and the few public comments found in files of FDIC-supervised banks relating to their CRA statement or CRA performance.

#### Bank Compliance with the CRA

Banks generally comply with CRA requirements. Banks which do not comply find that noncompliance violations can lay the groundwork for CRA protests and complaints against banks resulting not only in denials of applications but in costly time delays. Our overall experience, with few exceptions, has been that once a problem is brought to a bank's attention immediate steps are taken to correct it.

Of the 1,228 banks examined for CRA compliance by the FDIC in 1986, 20 were assigned less than satisfactory ratings. Also, preliminary figures indicate that about two percent (or 42) of the 2,155 banks examined for CRA compliance in 1987 had less than satisfactory ratings.

We believe that the low ratio of less than satisfactory ratings indicates that FDIC-supervised banks are in substantial compliance with the requirements and spirit of the CRA and Part 345 of the FDIC's regulations. A CRA rating does

not reflect an isolated instance of technical noncompliance with a regulation but is a rating of a bank's performance record over time. Violations, when detected by the FDIC, are called to the bank's attention as matters requiring immediate corrective action. Banks generally comply promptly.

Thus, the great majority of FDIC-supervised banks have been found to be in satisfactory or better compliance with the requirements of the CRA. When banks which were rated less than satisfactory on their most recent CRA examination apply for a branch, a relocation, or a merger, we investigate each situation and, when deemed appropriate, conduct an on-site CRA assessment. If the applicant bank is again found to be less than satisfactory as to CRA performance, the FDIC obtains commitments from the bank to favorably resolve all CRA-related problems before approval is granted. Such commitments may be informal or may be stipulated in a memorandum of understanding. No FDIC-supervised bank rated less than satisfactory on the basis of compliance with CRA has had its application approved without agreeing to appropriate corrective actions to favorably resolve FDIC-identified, CRA-related problems.

Since the Act's inception, the FDIC has denied three applications for deposit facilities due to CRA factors. This is .01 percent of the total number of applications subject to the CRA that were filed with the FDIC. The rate of application denials on CRA grounds, however, should not be considered the sole or even a major factor in measuring the effectiveness of the FDIC's use of its authority in enforcing the CRA. CRA-related problems often are corrected by banks at the request of the FDIC, prior to our action on an application. The incidence of such preapproval corrections have not been aggregated by the

FDIC. However, in May 1987, the FDIC's Division of Bank Supervision implemented a new Applications Tracking System which enhances our ability to ascertain which applications were protested based on CRA performance factors and to determine whether the FDIC imposed any CRA-related conditions in conjunction with the approval of those applications.

The FDIC received two CRA-related application protests in 1986 (against two banks) and nine in 1987 (against seven banks). In addition, we received six written CRA complaints and inquiries in 1986 and eight in 1987 that did not concern a specific bank application. Investigations of each of these complaints revealed no illegal CRA practices. Also, FDIC examiners have found very few CRA comments in banks' public files.

The FDIC's toll-free "hotline" also is useful in measuring the effectiveness of the FDIC's enforcement of the CRA. During 1987, the FDIC's Office of Consumer Affairs and our Regional Offices reported approximately 29,100 telephone calls for information and assistance. Of this number, only 194 calls involved community reinvestment matters. OCA also processed about 3,533 written complaints and inquiries, only eight of which involved CRA-related issues.

#### Improvements in the FDIC's CRA Program

Office of Consumer Affairs. In December 1986, the Board of Directors of the FDIC transferred consumer-affairs responsibilities from the Division of Bank Supervision to a newly established Office of Consumer Affairs. That Office is an independent component of the FDIC and its director reports directly to the Office of the Chairman.

The OCA staff includes a fair-lending analyst whose primary areas are community investment and civil rights. Among other responsibilities, OCA reviews all CRA-related protests filed against an FDIC-supervised bank in relation to an application and presents a written recommendation to our Division of Bank Supervision regarding the disposition of that bank's application. OCA also is charged with the task of continuously evaluating the adequacy of the FDIC's examination program as a mechanism for detecting and correcting violations of consumer protection and civil rights laws. This is in addition to the monitoring of our entire examination process by DBS.

Training. The FDIC provides CRA staff training in four primary ways. The bulk of compliance training, including CRA, is conducted on-site by senior field examiners. These individuals are generally the most experienced examiners who handle the more complex compliance and safety and soundness assignments. Our Regional Office staff keeps those examiners updated on all pertinent information relating to the scope of work assigned to them, including CRA-related information.

More formally, the FDIC's Division of Bank Supervision Training Center administers the Corporation's Consumer Protection School (CPS). Most CPS attendees are examiners with a minimum of two years' bank supervision experience. In 1986, there were three CPS sessions lasting eight days each resulting in the training of 39 students. In 1987, there were four CPS sessions lasting five days each which provided consumer protection and fair lending training to 62 FDIC students. In 1988, we plan to hold six five-day sessions with a total of 132 students scheduled to attend.



In addition to the above training, a two-hour overview of consumer protection laws is included in our advanced training for assistant examiners. We have had approximately ten sessions which included this overview, with approximately 25 assistant examiners (having an average of two years' experience) attending each session.

The FDIC's Office of Consumer Affairs also conducts a 2 1/2-day compliance seminar annually for Regional Office (OBS) Consumer Affairs and Civil Rights Review Examiners and their assistants and/or field examiners. Many of these Review Examiners then provide similar training seminars to their respective regional examination staffs.

We plan to continue our emphasis on compliance training programs, including CRA.

Examinations. The FDIC supervises nearly 9,000 banks. In 1985, approximately 1,069 banks were examined for compliance with the CRA. There were 1,228 examinations conducted in 1986 and approximately 2,155 during 1987. Because of the dramatic increase in the number of failed and problem banks in recent years, the FDIC has had to devote significantly more resources to problems involving safety and soundness.

We are working to improve examiner staffing shortfalls relative to compliance examinations. That endeavor will be facilitated by the provisions in the recently enacted Competitive Equality Banking Act removing the FDIC from certain budgetary constraints. We believe the significantly increased

compliance examination activity during 1987 will continue in 1988. Additional resources again will be allocated to compliance enforcement, including CRA, as we hire and train new examiners and as the number of problem banks begins to stabilize or decrease. In fact, in the budget that was approved by the FDIC Board of Directors on January 19, 1988, the number of compliance examinations during 1988 is projected to increase by approximately 60 percent.

#### Conclusion

As you know, Mr. Chairman, we have experienced a record number of bank failures over the last two years. Most have taken place in the hard-pressed farm and energy-dependent communities of the South, Southwest and Midwest. In at least 70 percent of these cases, the FDIC has been able to arrange the takeover of all or part of the failed bank by a healthy bank. This has important and positive social and economic consequences for the communities affected by bank failures. It means that along with the FDIC meeting its mandate to safeguard bank deposits, we have been able to secure continued access to credit for meeting local needs. The purchase of all or part of a failed bank by a healthy institution allows the banking relationships of local businesses and consumers to remain uninterrupted in many cases.

At the FDIC, we encourage the banks we supervise to help meet the credit needs of the residents of their local communities. We plan to do more outreach in order to increase awareness of the CRA among both consumers and bankers. Last March, we invited several community groups and consumer protection and civil rights organizations to the FDIC to meet with me and senior Corporation staff for an exchange of views on community reinvestment and other consumer and

community-related issues. That meeting was productive and another is being planned for 1988. In addition, to further our industry outreach efforts in the coming year, the FDIC plans to invite bankers from various parts of the country to compliance seminars where CRA concerns and other consumer-related laws and regulations will be addressed. We continue to believe that it is important to have regular dialogue with representatives from both community and consumer groups and the banking industry.

Thank you once again, Mr. Chairman and members of the Committee, for giving us this opportunity to express our views on an issue of special importance to the nation's communities and financial system. We will be pleased to respond to any questions.

Attachments



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20510

OFFICE OF THE CHAIRMAN

January 25, 1988

Dear Mr. Chairman:

The enclosed answers are in response to your letter of October 22, 1987, requesting information on the Federal Deposit Insurance Corporation's policies, procedures and regulatory experiences relative to the Community Reinvestment Act. As agreed to with your staff, we will respond by February 1 to the additional CRA questions posed in your letter of December 23, 1987.

We hope the enclosed information is helpful.

With best wishes.

Sincerely,

L. William Seidman  
Chairman

Honorable William Proxmire  
Chairman  
Committee on Banking, Housing  
and Urban Affairs  
United States Senate  
Washington, D.C. 20510

Enclosures

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## 1. GENERAL ENFORCEMENT

### I.a. Question:

Since enactment of the CRA, how many applications have been denied solely or substantially due to CRA factors? What percentage of total applications processed subject to the CRA does this represent? Does this rate of denial adequately enforce compliance with CRA, or would increased use of the sanctions provision strengthen compliance?

### I.a. Answer:

Since the Act's inception, the FDIC has denied three applications for deposit facilities due to Community Reinvestment Act factors. This is .02 percent of the total number of applications subject to the CRA. (The number of applications processed from 1979 through August 1987 was 14,586.) The rate of application denials on CRA grounds, however, should not be considered the sole or even a major factor in measuring the effectiveness of CRA enforcement.

We believe the means employed by the FDIC to enforce compliance with the CRA are generally effective. If we find a CRA problem, we issue a correction advisement. If necessary, we follow up the advisement with a memorandum of understanding. Other sanctions include the conditional approval of bank applications for deposit facilities.

Banks generally comply with CRA requirements. Those which do not, however, find that violations can lay the groundwork for CRA protests and complaints against banks resulting not only in denials but in costly time delays. At the FDIC, our experience has been that once a problem is brought to a bank's attention, immediate steps are taken to correct it.

### I.b. Question:

How many examinations of regulated institutions that assess CRA compliance are conducted each year? On average, how often is a regulated institution's compliance with the CRA assessed through an examination?

### I.b. Answer:

The FDIC supervises nearly 9,000 banks. In 1985, 1,069 compliance examinations and visitations including CRA were conducted. There were 1,125 in 1986 and 1,824 during 1987. Because of the dramatic increase in the number of failed and problem banks in recent years, the FDIC has had to devote more resources to problems involving safety and soundness.

We are working to improve this manpower situation relative to compliance examinations, and certainly that endeavor will be facilitated greatly by the provisions in the recently enacted Competitive Equality Banking Act removing

the FDIC from certain budgetary constraints. We believe the increased compliance examination activity during 1987 will continue in 1988. Additional resources will be allocated again to compliance enforcement, including CRA, as we hire and train new examiners and, eventually, as the number of failed and problem banks begins to decrease. In fact, in the budget that was approved by the FDIC Board on January 19, 1988, the number of compliance exams during 1988 is projected to increase by approximately 60 percent.

The FDIC's compliance examination goals differ by compliance ratings. For 1- and 2-rated banks, the goal is assessment every 36 months. For 3-rated banks, the goal is every 18 months, and for 4- and 5-rated banks, the goal is every 12 months. To the extent that we are able to continue hiring additional bank examination staff, we will be better able to achieve our compliance examination goals.

### I.c. Question:

What quantitative and qualitative criteria does your agency use to measure the effectiveness of regulatory enforcement of the CRA? What factors indicate that CRA enforcement has been effective? What factors indicate that CRA enforcement has not been effective?

### I.c. Answer:

The FDIC rates banks in accordance with the Uniform Interagency CRA Assessment Rating System. The ratings range from 1 to 5, with one being the best. We give special attention to banks with compliance and CRA ratings of "3," "4," and "5."

In order to enforce compliance with the CRA, in 1978 the FDIC adopted Part 345 of its regulations along with concomitant examination procedures set forth in our Compliance Examination Manual. The major measures of effectiveness are based on the assessment factors outlined in Part 345. These include, but are not limited to, activities conducted by the bank to ascertain the credit needs of their communities and the bank's marketing of its services; the types of credit offered and extended by the bank to the community; the geographic distribution of the bank's loans; the impact of the opening or closing of offices and the services offered at these facilities; the bank's compliance with anti-discrimination and other credit laws; and the bank's participation in community development in order to meet local credit needs.

In conducting a CRA examination, the examiner evaluates banks on a case-by-case basis to take into account banks that vary in size, expertise and locale. Community credit needs often differ with the specific characteristics of each local community, and banks are evaluated on the basis of attempts to ascertain, determine, and help meet community credit needs in the context of local circumstances and resources.

The main factors which indicate whether our CRA enforcement policies and procedures are effective include the number of banks which receive a satisfactory or higher CRA rating, the number of CRA consumer complaints or protests we receive, and the number of public comments found in files of banks relating to a bank's CRA statement or to the bank's performance in helping to meet the credit needs of its community.

The FDIC received two application protests in 1986 and seven in 1987. In addition, we received six CRA complaints in 1986 and eight in 1987 that did not concern a specific bank application. Investigations of each such complaint revealed no findings of illegal practices involving the CRA. Also, FDIC examiners have found very few CRA comments in the public files of banks.

Another means of assessing the effectiveness of the FDIC's enforcement of the CRA is the FDIC's toll-free "hotline." For the first six months of 1987 the FDIC's Office of Consumer Affairs and our Regional Offices reported approximately 14,120 calls for information and assistance. Of this number only 77 calls involved community reinvestment matters.

Additionally, within the last year we have restructured the FDIC Office of Consumer Affairs. That Office now operates independently of our Division of Bank Supervision and continuously evaluates the adequacy of the Corporation's compliance examination program.

We believe that the FDIC's CRA enforcement efforts generally have been effective. As mentioned above, however, we plan to increase the number of FDIC compliance examinations in 1988. We think the following factors would indicate that FDIC enforcement was not being effective: a larger percentage of banks with less than satisfactory ratings; a significantly increasing number of CRA protests and/or CRA complaints along with findings of unlawful conduct; heavier input into bank public files indicating community reinvestment problems; or increasing communications from community groups or individuals indicating possible problems with FDIC-supervised banks. We are not seeing evidence of these negative indicators.

## II. CRA Ratings

### II.a. Question:

How many regulated institutions were assigned CRA ratings of "3", "4", or "5" in 1986? What percentage of total rated institutions received these ratings? Were each of these institutions examined in 1986, or did some ratings rely on previous examinations? On what basis can the low level of "less than satisfactory" CRA ratings be justified?

### II.a. Answer:

Of the 1,128 banks examined by the FDIC in 1986 for CRA compliance, 20 were assigned less than satisfactory ratings. As of June 1987, under 2 percent (or 132) of all FDIC-supervised banks examined for CRA compliance had less than satisfactory ratings.

The low ratio of less than satisfactory ratings, we believe, indicates that FDIC-supervised banks are in substantial compliance with the requirements of the CRA and Part 345 of the FDIC's regulations. A CRA rating does not reflect an isolated instance of technical noncompliance with a regulation but is a rating of a bank's investment record over time. Violations, when detected by the FDIC, are called to the bank's attention as matters requiring immediate corrective action. Banks generally comply promptly.

### II.b. Question:

Have applications for institutions with CRA ratings of "3", "4", or "5" been approved by your agency? If so, how can these approvals be justified?

### II.b. Answer:

No FDIC bank rated less than satisfactory on the basis of compliance with CRA has had its application approved without agreeing to appropriate corrective actions to favorably resolve FDIC-identified CRA-related problems.

As indicated above, the great majority (98%) of FDIC-supervised banks have been found to be in satisfactory or strong compliance with the requirements of the CRA. When banks which were rated less than satisfactory on their most recent CRA examination apply for a branch, a relocation, or a merger, we investigate each situation and, when deemed appropriate, conduct an on-site CRA assessment. If the applicant bank is again found to be less than satisfactory as to CRA performance, the FDIC obtains commitments from the bank to favorably resolve all CRA-related problems before approval is granted. Such commitments may be informal or may be stipulated in a memorandum of understanding.

In May 1987, the FDIC's Division of Bank Supervision implemented a new Applications Tracking System which will enhance our ability to ascertain which applications were protested based on CRA performance factors and to determine whether we imposed any CRA-related conditions upon the approval of those applications.

### II.c. Question:

The regulatory agencies have long held the position that individual CRA ratings should not be made public, to protect the confidential relationship between a regulator and the regulated institution. However, the intent of Congress in enacting CRA was that, consistent with safety and soundness, sanctions could be imposed on regulated institutions with inadequate CRA records. The use of public CRA ratings would appear to reward institutions with good ratings and sanction institutions with less than satisfactory ratings. Is there any movement in the direction of public disclosure of individual CRA ratings by your agency?

### II.c. Answer:

Currently there are no plans at the FDIC to publicly disclose individual CRA ratings, and we do not believe such disclosure is necessary at this time. The Home Mortgage Disclosure Act (HMDA) serves to provide the public with important information to enable them to determine whether depository institutions appear to be fulfilling their obligations in meeting the housing needs of the communities and neighborhoods in which they are chartered to do business. If there are indications of problems, the FDIC investigates. We believe that the banking agencies' supervisory efforts regarding community reinvestment have proven workable and effective.

### III. HOME MORTGAGE DISCLOSURE ACT

#### III.a. Question:

When regulatory examinations of an institution's HMDA statements show that few or no housing loans are being made in low- or moderate-income areas, and that the volume of loans in these areas is disproportionately low compared to the volume of loans in other areas of the local community, how is this interpreted by your agency? If HMDA records indicate "unreasonable" lending patterns, is this sufficient cause for denial of an institution's application? If not, what steps are taken by your agency to correct the imbalance?

#### III.a. Answer:

From a regulatory standpoint, HMDA statements serve as a tool for closer analysis if and when problems concerning a bank's CRA compliance are suspected. The HMDA statement is generally considered a reliable indication of the number and dollar amount of mortgage loans extended in a bank's lending area.

At times, a bank's HMDA statement may reveal a disproportionately low number of loans in low- or moderate-income areas relative to other areas in the community. If this is found, our examiners investigate further into the reasons for any such patterns. If such a lending pattern cannot be justified, it would serve as a basis for a less than satisfactory CRA rating. The FDIC would advise the bank to improve its record by seeking to meet the credit needs of those in its lending community.

We cannot conclude, however, solely on the basis of few loans in low- or moderate income areas relative to other areas, that there has been a violation of CRA or fair lending laws. HMDA statements alone are not capable of supporting such conclusive interpretations. A HMDA statement which leads to questions about a bank's lending patterns serves as a valuable indicator for FDIC examiners. It causes an examiner to research, for example, whether omitted census tracts are indeed zoned residential, whether a bank's advertising of loan programs is actually reaching residents of these locales, and whether any demand for loans has emanated from these areas and if not, why not. These questions tie-in directly with the CRA assessment factors. As stated earlier, findings based on these factors have resulted in remedial corrective advisements, memoranda of understanding, and delayed or conditional approval of applications. They also have resulted in application denials.

#### III.b. Question:

There is an increasing call by community groups to expand HMDA to include disclosure of small business loans. Given the fact that the CRA assessment criteria specifically includes an institution's small business lending record, would an expansion of HMDA to include small business loans be appropriate?

#### III.b. Answer:

The focus of HMDA is on home mortgage disclosure and expanding this Act would change this focus. Moreover, as regulators we need to become more familiar with the views of small business borrowers before making any such recommendation. Before requiring disclosure of small business loans, it would

be necessary to have an agreed-upon definition acceptable and applicable to the various geographic regions with differing economic environments. This will likely present considerable difficulties.

### IV. THE SECONDARY MARKET

#### IV.a/b. Question:

Is there any evidence that banks avoid making loans in certain low income areas because of the need to resell all loans to the secondary market? Have you discussed this situation with secondary market players? Can you come to a regulatory solution?

#### IV.a/b. Answer:

The FDIC is not aware of any evidence that banks avoid making loans in certain low income areas because of the need to resell all loans to the secondary market. We have not discussed the matter with secondary market participants, because we have received no complaints, written or oral, concerning this matter from either bankers or consumers. We do not believe any bank regulatory action is warranted at this time.



FEDERAL DEPOSIT INSURANCE CORPORATION

FACE OF THE CHAIRMAN

February 1, 1988

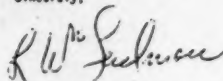
Dear Mr. Chairman:

The enclosed materials are furnished in response to your letter of December 23, 1987, requesting additional information concerning the Federal Deposit Insurance Corporation's enforcement of the Community Reinvestment Act.

We hope the enclosed information is helpful.

With best wishes.

Sincerely,



L. William Seidman  
Chairman

Honorable William Proxmire  
Chairman  
Committee on Banking, Housing  
and Urban Affairs  
United States Senate  
Washington, D.C. 20510

Enclosures

Item (a): CRA staff training: Include a profile of the staff trained, the type of training and the average training period.

Response: FDIC CRA staff training is provided primarily in four ways. The bulk of compliance training, including CRA, is conducted on-site by senior field examiners. These individuals are generally the most experienced examiners who handle the more complex compliance and safety and soundness assignments. Our Regional Office staff keeps these examiners updated on all pertinent information relating to the scope of work assigned to them, including CRA-related information.

More formally, the FDIC's Division of Bank Supervision Training Center administers the Corporation's Consumer Protection School (CPS). Most CPS attendees are examiners with a minimum of two years' bank supervision experience:

| Year | Total Number of Sessions | Length of Each Session | Total # of FDIC Students | Hours of Fair Lending Training Per Session | CRA | PH | CCA | NMCA |
|------|--------------------------|------------------------|--------------------------|--------------------------------------------|-----|----|-----|------|
| 1987 | 4                        | 5 Days                 | 62                       | 2                                          | 2   | 3  | 1   |      |
| 1986 | 3                        | 8 Days                 | 39                       | 3.5                                        | 2   | 5  | 2   |      |
| 1985 | 3                        | 8 Days                 | 38                       | 3.5                                        | 2   | 5  | 2   |      |
| 1984 | 2                        | 8 Days                 | 34                       | 3.5                                        | 2   | 5  | 2   |      |

In addition to the above training, a two-hour overview of consumer protection laws is included in our advanced training for assistant examiners. We have had approximately 10 sessions which included this overview, with approximately 25 assistant examiners (with approximately 2 years' experience) attending each session.

Also, the FDIC's Office of Consumer Affairs (OCA) annually conducts a 2 1/2-day compliance seminar for Regional Office (DBS) Consumer Affairs and Civil Rights Review Examiners and their assistants and/or field examiners. Many of these Review Examiners then provide similar training seminars to their respective regional examination staffs.

Item (b): CRA examination process: Include an estimate of examination time by size of institution (with thresholds of \$25, \$100 and \$500 million); actual examination reports on institutions which have been the subject of consumer protests during 1985-87, and a description of supervisory procedures to correct identified violations.

Response: For compliance examinations undertaken during 1985, 1986, and 1987, the average examination time ranged generally from 8 hours to 40 hours for smaller banks and up to 200 hours for larger banks. Hours, however, may relate more to the type of bank (e.g., commercial vs. savings bank, wholesale vs. retail) than to asset size. For special CRA examinations conducted in response to a bank application or a protest during each of the 3 years cited, the number of hours expended was substantially higher. Also, there were several examinations where (because of type, size and/or location of the bank) only 1 or 2 hours were spent on CRA -- a factor which lowers considerably the

The CHAIRMAN. Thank you very much, Chairman Seidman. Comptroller Clarke, before you start, I'm going to have to leave now for the floor and Senator Graham is going to chair the Committee. Senator Garn is going to be here shortly. He has a statement that he's making and he will be here at 10:45 I understand. Senator GRAHAM. Mr. Clarke.

**STATEMENT OF ROBERT L. CLARKE, COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY**

Mr. CLARKE. Mr. Chairman and members of the Committee, the Office of the Comptroller of the Currency (OCC) strives to carry out its supervisory objectives with respect to the Community Reinvestment Act (CRA) through a program that encourages positive action by national banks and cooperation among the OCC, the banks, and the public.

Our program is discussed in detail in my written testimony and in the attached report that we provided to Chairman Proxmire in January. In the interest of time, I will highlight only the most important points of my written testimony.

A bank's performance is first—and foremost—the responsibility of its management. Thus, in our view, we can best supervise national banks by insisting that they have effective management policies, systems and controls to ensure that competitive efforts are consistent with safety and soundness.

We urge banks to establish those policies, systems and controls. We make sure they are followed. And—most important—we make sure they work. This approach to supervision makes efficient use of our limited resources while resulting in adherence to safe and sound practices.

In meeting our responsibilities under the CRA, we follow the same supervisory approach. We require banks to have policies, systems and controls for compliance and then we monitor those policies, systems and controls. In addition, during all the compliance examinations we conduct, examiners assess compliance with the CRA through consideration of a number of factors, including twelve assessment guidelines jointly published by the bank regulatory agencies.

Demands on our examination force make it impossible to conduct annual compliance examinations in each of the approximately 4,600 national banks. Therefore, we have developed a process for selecting banks to be examined for compliance, a process that, we believe, best allocates our resources.

The selection process and the time we spend in the examination strike the right balance between supervision for safety and soundness and supervision for compliance with other laws and regulations. And we believe that this approach to supervision encourages a high degree of compliance with CRA.

During the last year, 800 individual banks—representing approximately 40 percent of the national banking system's total assets—were examined under our compliance program. In 1987, 59 national banks were rated three, four or five for overall CRA performance—which means that we found their performance running from less than satisfactory to substantially inadequate.

Mr. Chairman, since enactment of the CRA, the OCC has denied four corporate applications because of less than satisfactory CRA performance, but it is important to remember that denials are a last resort. They are used only when the far more effective tactic of conditional approval appears to have little, if any, chance of modifying bank performance. Conditional approval provides the OCC with substantial enforcement leverage by explicitly tying a bank's objective to tangible improvement of its CRA performance—thus benefiting the community. The OCC has approved 23 applications with specific conditions requiring the applicant banks to strengthen their CRA records.

In conclusion, Mr. Chairman, I would like to stress that bank supervision—like bank management—is a process that seeks results over time. As our former chief counsel once said of bank supervision: "we are in the business of changing human behavior." And that means we are in the business of changing people's attitudes. We believe that education and outreach are the most effective means we have to change human behavior—to change people's attitudes—in the long run.

So at the OCC we have expanded on the statutory requirements of CRA by encouraging banks through education and outreach to increase their sensitivity to customer and community needs. The report submitted to Chairman Proxmire in January discusses at length five prominent types of educational and outreach activities in which we engage. Additional information about the liaison and education efforts of our Customer and Industry Affairs Division is contained in this brochure which has previously been furnished to each of you.

We are pleased with the results of these efforts—and we expect to do more.

I will be pleased, Mr. Chairman, to answer any questions that you or the other members of the Committee may have. Thank you.

[The complete prepared statement of Robert L. Clarke follows:]

average time expended per compliance examination. The following Table shows the average number of hours spent per examination on CRA compliance matters.

Average Hours Expended Per Examination on CRA

| <u>Average Hours<br/>Per Exam</u> | <u>\$25 million</u> | <u>\$100 million</u> | <u>\$500 million</u> |
|-----------------------------------|---------------------|----------------------|----------------------|
| 1985                              | 6                   | 7 1/4                | 23                   |
| 1986                              | 5 1/2               | 10 1/2               | 18                   |
| 1987                              | 5                   | 8                    | 23                   |

As agreed to with your staff, in lieu of the actual compliance examination reports initially requested, we have enclosed examples of two redacted compliance reports. We believe these illustrate the compliance enforcement practices followed by the FDIC.

To correct a compliance problem, including any CRA-related instance, we bring the issue to the bank's attention both orally and in writing. We also issue a correction advisement and, if necessary, issue a memorandum of understanding. Other sanctions include denying (or approving upon condition of compliance with the CRA) a bank's application for depository facilities. In extreme cases, we also have the authority to initiate a formal enforcement proceeding against the bank.

Item (c): CRA procedures: include procedures governing notice, comment, extensions and hearings, and monitoring of settlement agreements; report on disposition of protests (1981-87); include case files on applications protested 1985-87.

Response: Enclosed is a copy of A Citizens Guide to CRA prepared by the Federal Financial Institutions Examination Council. This publication contains a general explanation of the FDIC's CRA procedures. Excerpts from our Manual for Compliance Examinations also are provided. FDIC staff are reviewing current procedures to determine whether revisions are needed.

The FDIC does not, as a general rule, monitor CRA-related settlement agreements unless they were associated with a CRA protest. However, agreements are reviewed as part of the regular examination process.

The disposition of the CRA protests filed from 1981-1984 is as follows:

| <u>Applicant Bank</u>                                           | <u>Disposition</u>   |
|-----------------------------------------------------------------|----------------------|
| 1981 Hamilton Bank<br>Lancaster, Pennsylvania                   | Application Approved |
| State Bank of Raleigh<br>Raleigh, North Carolina                | Application Approved |
| 1982 The Boston Five Cent Savings Bank<br>Boston, Massachusetts | Application Approved |
| 1983 No protests received                                       |                      |
| 1984 No protests received                                       |                      |

The enclosed CRA Protest Summary Table includes disposition information on the CRA protests filed with the FDIC from 1985 through 1987. As agreed to with your staff, this Table is a substitute for the case files initially requested in your letter.

## CRA PROTESTS AGAINST FDIC-SUPERVISED BANKS

| APPLICANT'S NAME/ADDRESS                                                           | PROTESTANT'S ADDRESS                                                                                                                                   | TYPE AND DATE OF APPLICATION       | SUBJECT OF THE PROTEST                                                                                                                                                                                                                                                                                                                                                                                   | DISPOSITION                                                                                                                                                                                  |
|------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 1985                                                                               |                                                                                                                                                        |                                    |                                                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                              |
| The Arizona Bank<br>101 North 1st Avenue<br>Phoenix, Arizona 85003                 | Arizona Association of<br>Community Organizations<br>for Reform NOW (ACORN)<br>917 North 5th Street<br>Phoenix, Arizona 85004                          | Branch - April 18, 1985            | <ul style="list-style-type: none"> <li>- Inadequate ascertainment of community credit needs;</li> <li>- Geographic distribution of credit;</li> <li>- Service charges too high.</li> </ul>                                                                                                                                                                                                               | Informal hearing held July 10, 1985. FDIC approved application October 8, 1985.                                                                                                              |
| Commercial and Industrial Bank<br>200 Madison Avenue<br>Memphis, Tennessee 38103   | Mid-South Peace and Justice Center<br>P.O. Box 11428<br>Memphis, TN 38111-0426                                                                         | Branch - July 15, 1985             | <ul style="list-style-type: none"> <li>- Inadequate branches in low and moderate income areas;</li> <li>- Insufficient number of housing loans;</li> <li>- Inadequate advertising.</li> </ul>                                                                                                                                                                                                            | Informal proceeding held on September 18, 1985; FDIC approved application November 7, 1985.                                                                                                  |
| 1986                                                                               |                                                                                                                                                        |                                    |                                                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                              |
| The Waterloo Savings Bank<br>825 Cedar Street<br>Waterloo, Iowa 50701              | Citizens for Community Improvement<br>581 Sycamore Street<br>P.O. Box 875<br>Waterloo, Iowa 50704                                                      | Merger - April 16, 1986            | <ul style="list-style-type: none"> <li>- Inadequate home improvement loans and small business loans;</li> <li>- Asked for increased contributions to local foundations.</li> </ul>                                                                                                                                                                                                                       | Examiner met with representatives of protestant. FDIC approved application September 24, 1986.                                                                                               |
| People's Trust Company<br>145 Westminster Street<br>Providence, Rhode Island 02901 | South Providence Re-vitalization Committee, Inc.<br>386 Prairie Avenue<br>Providence, Rhode Island 02905                                               | Branch Relocation - April 23, 1986 | <ul style="list-style-type: none"> <li>- Protestants not sent current CRA and HMDA statements.</li> <li>- Inadequate determination of community credit needs; communication with community; inadequate geographical distribution of credit extensions.</li> </ul>                                                                                                                                        | FDIC approved application May 21, 1986.                                                                                                                                                      |
| 1987                                                                               |                                                                                                                                                        |                                    |                                                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                              |
| United Bank of Texas<br>108 Travis<br>Houston, Texas 77251                         | Houston Reinvestment Alliance<br>c/o Robinson & Davis Attorneys<br>2905 Elgin Ave<br>Houston, Texas 77288                                              | Branch - May 13, 1987              | <ul style="list-style-type: none"> <li>- HMDA statement evidences failure to meet the credit needs of low and moderate income and minority residents;</li> <li>- Inadequate distribution of housing loans;</li> <li>- Alleged violation of discrimination under CRA, the Fair Housing Act and ECDA, including discouragement.</li> <li>- Lending record of low and moderate income residents.</li> </ul> | Application held in abeyance by FDIC until application for OCC charter and merger acted upon.                                                                                                |
| Same as above                                                                      | NAACP - Houston Branch<br>4101 San Jacinto, Suite 233<br>Houston, Texas 77004                                                                          | Same as above                      |                                                                                                                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                              |
| Everly Bank<br>357 West 103rd Street<br>Chicago, Illinois 60643                    | Chicago Roseland Coalition for Community Control<br>c/o Legal Assistance Foundation of Chicago<br>343 South Dearborn Street<br>Chicago, Illinois 60604 | Branch - June 15, 1987             | <ul style="list-style-type: none"> <li>- Failure to meet credit needs of lending community;</li> <li>- Bank does not make mortgage loans.</li> </ul>                                                                                                                                                                                                                                                     | Protest withdrawn September 16, 1986, following signed CRA agreement between bank and protestant; Informal proceeding held on October 13, 1987; FDIC approved application December 17, 1987. |



## CRA PROTESTS AGAINST FDIC-SUPERVISED BANKS

| APPLICANT'S NAME/ADDRESS                                                                     | PROTESTANT'S ADDRESS                                                                                                                                                 | TYPE AND DATE OF APPLICATION                            | SUBJECT OF THE PROTEST                                                                                                                                                                                                                                                                                     | DISPOSITION                                                                                                                               |
|----------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------|
| Same as above                                                                                | Council on Employment and Economic Development (CEED)<br>Coordinating Committee<br>c/o Chicago Urban League<br>4510 South Michigan Avenue<br>Chicago, Illinois 60653 | Same as above                                           | - Failure to meet credit needs of the lending community.<br>- Discrimination against Black student loan applicants.                                                                                                                                                                                        | FDIC offered to meet with protestant but offer was declined.                                                                              |
| The Merchants and Planters Bank of Raymond, Mississippi<br>P.O. Box 699<br>Raymond, MS 39154 | Mr. Berry G. Thompson<br>Supervisor<br>Hinds County, Mississippi<br>1-20 N. Frontage Rd<br>Rte 1, Box 28-6<br>Bollen, Mississippi 39041                              | Merger -<br>September 12, 1986                          | - Discriminatory lending;<br>- Failure to involve minorities in the affairs of the bank.                                                                                                                                                                                                                   | 1987 exam reflected CRA compliance; FDIC approved application August 4, 1987.                                                             |
| Delaware Trust Company<br>900 Market Street Mall<br>Wilmington, Delaware 19801               | Community Legal Aid Society, Inc.<br>913 Washington Street<br>Wilmington, Delaware 19801                                                                             | Phantom Merger - September 14, 1987                     | - Failure to meet the convenience and needs of low and moderate income and minority residents;<br>- Discriminatory treatment;<br>- Failure to adequately ascertain credit needs or to develop an adequate marketing program;<br>- Inadequate CRA statement;<br>- Failure to provide the CRA public notice. | Following adoption by the bank of a formal plan to correct CRA-related deficiencies, the FDIC approved the application November 30, 1987. |
| Citytrust<br>961 Main Street<br>Bridgeport, Connecticut 06601                                | Asylum Hill<br>Organizing Project<br>243 Sigourney Street<br>Hartford, Connecticut 06105                                                                             | Two branches -<br>October 29, 1987<br>November 12, 1987 | - "Very poor lending practice in minority neighborhoods";<br>- Bank has played a major role in the disinvestment of the Asylum Hill Community.                                                                                                                                                             | FDIC offered to meet with protestant but no response; application pending.                                                                |
| Peoples and Union Bank<br>P.O. Box 589<br>Lewisburg, Tennessee 37091                         | The Tennessee<br>Save the Family<br>Farm Alliance<br>Route 2, Box 46-A1<br>Indian Mound, Tennessee 37079                                                             | Merger - August 31, 1987                                | - Discriminatory lending practices toward farmers, e.g., higher interest rates charged relative to other equivalent risk loans;<br>- Avoidance of FmHA guaranteed farm loans;<br>- Inflexible foreclosure practices;<br>- Improper linkage of farm debt with consumer loans.                               | FDIC offered to meet with protestant but no response; application pending.                                                                |

For release upon delivery

STATEMENT OF  
ROBERT L. CLARKE  
COMPTROLLER OF THE CURRENCY  
Before the  
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS  
UNITED STATES SENATE  
March 23, 1988

INTRODUCTION

Mr. Chairman and members of the Committee, I am here today to discuss the responsibilities of the Office of the Comptroller of the Currency under the Community Reinvestment Act of 1977 (CRA). The CRA was enacted out of concern that banks were making loans outside of their local communities without first considering local lending opportunities, and that there were unwarranted differences in lending patterns between neighborhoods in communities served by lenders. It emphasizes the affected lending institutions' affirmative obligations to help meet the credit needs of their local communities, while maintaining safe and sound operations.

The Office of the Comptroller of the Currency continues to endorse the broad objectives of the CRA and strives to carry out its supervisory objectives with respect to the CRA through a program that encourages positive action by the national banks which we supervise and cooperation among the OCC, the banks, and the public.

My testimony will describe the approach taken by the OCC in discharging its supervisory responsibilities with respect to the CRA. The first section will describe those supervisory responsibilities under the CRA and relate those responsibilities to our general approach to bank supervision. The second section will discuss the specific actions the OCC takes to meet its responsibilities under the CRA. Details on those activities and a description of our efforts to maintain contacts with bank customer groups are contained in a report that we provided to you, Mr. Chairman, in January. (The report is appended to this statement.)

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CRA RESPONSIBILITIES AND THE OCC'S SUPERVISORY PHILOSOPHY

The Community Reinvestment Act

The Community Reinvestment Act (12 U.S.C. 2901 et seq.) was enacted in 1977 and requires:

...each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.

Each agency must:

assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution; and

take such record into account in its evaluation of an application for a deposit facility by such an institution.

The OCC bases its supervisory efforts on the premise that a bank's performance is, first and foremost, the responsibility of its management. Thus, in our view, we can best supervise national banks by insisting that they have policies, procedures, systems, and controls in place to ensure that their competitive efforts are consistent with safety and soundness. We monitor not only their establishment of such policies, procedures, systems, and controls, but we also make sure that they are followed. Most importantly, we make sure that they work. We do this through on-site and off-site examination and through contact with bank management and directors as needed.

We believe that this supervisory approach is effective and that it makes efficient use of our limited resources. It results in better adherence to safe and sound practices. The systems are effective because every day management decisions are made with their guidance.

This supervisory philosophy is incorporated into our approach to discharging the responsibilities mandated by the CRA. First, we require banks to establish policies and procedures consistent with the spirit and intent of the CRA, and to establish systems to ensure that those policies and procedures are effectively implemented. Then, during the examinations, we monitor whether the banks' own systems are working, and require changes when necessary. This dual strategy of requiring systems for compliance and then monitoring the performance of those systems underlies our supervisory approach, not only to the CRA, but to all areas in which banks must comply with state and federal law.

# THE OCC'S CRA EFFORTS

To meet its supervisory responsibilities under the CRA, the OCC:

- o ~~assesses the bank's record~~ through examinations; and
- o ~~takes the bank's record into account~~ during the evaluation of corporate applications for deposit facilities.

The OCC has gone beyond the examination and corporate application processes by encouraging banks to increase their sensitivity to customer and community needs. Five prominent types of educational and outreach activities are discussed at length in our January report: (1) OCC-initiated meetings with customer groups and state banking and trade associations; (2) OCC-sponsored conferences, training sessions and publications on community lending and CRA issues; (3) OCC issuances; (4) participation by OCC senior management and staff at meetings sponsored by banking and bank customer groups; and (5) the OCC's Community Development Corporation (CDC) Program.

Today I would like to focus on the examination and corporate application review activities designed to encourage compliance with the intent of the CRA.

## Encouraging CRA Compliance through Examination

CRA performance is assessed by examiners during all compliance examinations that we conduct. The examination is part of our overall Compliance Program--the OCC's separate mechanism for promoting compliance with a complex body of laws, including those intended to protect the community and the consumer, and to promote fair lending. After the examination, reports are provided to directors and management about their bank's CRA performance, as well as on its compliance with other laws.

Compliance with the CRA is assessed through consideration of a number of factors, both positive and negative. They include: activities conducted by the bank to ascertain community credit needs; the extent of the bank's marketing efforts to make community members aware of credit services; participation by the bank's board of directors in formulating the bank's policies and reviewing its CRA performance; the existence of practices intended to discourage applications for credit from the local community; geographic distribution of the bank's credit extensions, applications, and denials; evidence of prohibited discriminatory practices in local development projects; and the bank's origination of loans for residential mortgages, home improvement, housing rehabilitation, and small businesses or small farms.

**Selection for examination.** Demands on our examination force make it impossible to conduct compliance examinations in each of the approximately 4,600 national banks on an annual (or otherwise regular) basis. Consequently, we have developed a selection process that we believe best allocates our resources. It strikes the right balance between supervision for safety and soundness and supervision for compliance with other laws and regulations and it encourages a high degree of compliance with the CRA. The selection process provides for a thorough examination of the lead national banks (and subsidiaries and affiliates, where appropriate) of all holding companies with more than \$1 billion in assets every other year. All other national banks are selected for examination using a stratified random sample. The average probability of being randomly selected is .16, with larger institutions having a higher probability of being selected than smaller institutions. Uncertainty associated with being randomly selected provides an incentive for compliance in the same way that the possibility of being audited by the IRS provides an incentive for compliance with the federal income tax laws. During the past year, 800 individual banks have been examined under the Compliance Program, representing approximately 40 percent of the total assets of all national banks.

Other assessments of CRA performance may be conducted through targeting and special investigations of banks that were not selected under the Compliance Program. Banks may be selected for CRA examinations if they are actively engaged in expansion through merger or branching, or if the supervising examiner has discovered unsatisfactory operating procedures through the commercial examination that could call into question their CRA procedures.

**Examination Results: CRA Ratings.** The OCC uses a uniform interagency rating system for evaluating the performance of federally regulated institutions under the CRA. A rating is assigned to each financial institution based on the institution's performance in meeting community credit needs. Areas of evaluation include bank performance under the assessment factors detailed in the CRA regulation, public files containing comments from the community on bank performance under the CRA, and community contacts initiated by our office or by community groups. Banks may be given CRA ratings ranging from 1 to 5. A rating of 3 is given to banks whose CRA performance is less than satisfactory; a 5 rating represents a substantially inadequate record of helping to meet community credit needs. We do not believe that a large number of banks should necessarily fall into the 3, 4, and 5 rating categories. In general, we have found that banks historically have helped to meet local community credit needs, consistent with safety and soundness requirements, and that they continue to do so. In 1987, fifty-nine national banks were rated 3, 4, or 5 for overall CRA performance.

Examination Results: Reports to Bank Management. An integral part of the examination is the report provided to bank directors and management summarizing the results of the examination. The report contains the examiner's assessment of the bank's CRA performance and any recommendations for improving that performance. This guidance provided to management through the written report and recommendations promotes a high level of CRA compliance.

Encouraging CRA Performance through the Application Process

The OCC considers the CRA performance of national banks when evaluating their corporate applications for charters, charter conversions, branches, mergers, and relocations of home and branch offices. This information is derived from examinations conducted in the course of the Compliance Program, and from targeted examinations or special investigations triggered by an application, from data collected under the Home Mortgage Disclosure Act, and from public comments.

Since enactment of the CRA, the OCC has denied four corporate applications due to less than satisfactory CRA performance. This low number reflects our view that conditional approvals are more effective than denials in promoting the objectives of the Community Reinvestment Act. The OCC has approved 23 applications with specific conditions requiring the applicant banks to strengthen their CRA performance. Under such circumstances, the banks cannot consummate the transactions in question until they provide concrete evidence to the OCC that their CRA performance has been strengthened. As a result, the conditional approval approach provides the OCC with substantial enforcement leverage by explicitly tying a bank's achievement of a desired objective to improvement of its CRA performance. This procedure produces results. And communities benefit through the corrective actions taken in response to the OCC-imposed conditions.

In addition to the OCC's action on the approval of applications, the objectives of the CRA can be promoted by meetings between applicants and concerned community groups while an application is in process. However, the OCC does not require, and does not intervene in, such meetings, nor do we approve or monitor performance under any agreements that may be negotiated between applicants and community groups.

SUMMARY AND CONCLUSION

Mr. Chairman, the OCC has developed a comprehensive program to encourage national banks to help meet the credit needs of their local communities. We believe that we have developed a program that strikes the right balance between the competing demands for our supervisory resources. We use on-site examination programs to make sure that national banks comply with the law. We train our examiners to assess national banks' compliance efforts and accomplishments. We consider the results of our assessments in evaluating corporate applications and have caused national banks to strengthen their CRA performance. We maintain contacts with community and banking groups to help ensure that all parties understand the needs and resources of each other.

We believe that most national banks help meet the credit needs of their local communities in the ordinary course of doing business. The OCC has not found it necessary to deny many applications on CRA grounds. Denials are a last resort. They are used only when the far more effective tactic of conditional approval has little, if any chance, of modifying bank performance.

Administration of the Community Reinvestment Act  
by the  
Office of the Comptroller of the Currency

January 1988

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## I. INTRODUCTION

This report was prepared in response to a request from Senator William Proxmire, Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, for information on the enforcement of the Community Reinvestment Act (CRA) by the Office of the Comptroller of the Currency (OCC). It provides commentary and data on CRA training for examiners, the results of CRA examinations, the disposition of applications subject to CRA, and the other issues Chairman Proxmire specifically asked the OCC to address. To assist in an understanding of the entire OCC effort under CRA, this report also contains information on OCC compliance with requirements not raised by Chairman Proxmire. The remainder of this Introduction sketches all the requirements imposed by CRA and outlines the body of this report.

### The Community Reinvestment Act

The Community Reinvestment Act (12 U.S.C. 2901 *et seq.*) was enacted in 1977 and requires:

...each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.

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### Each agency must:

assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of such institution; and

take such record into account in its evaluation of an application for a deposit facility by such institution.

The term "application for a deposit facility" is defined to include applications for charters (including charter conversions), branches, mergers, relocations of home and branch offices, and deposit insurance.

The term "examining", as used in the law, also requires comment. The OCC has long viewed its basic mission to be that of supervising national banks. Supervision requires on-going monitoring of bank activities and contact with bank officials as needed. Supervision includes, but is not restricted to, on-site examination. Consequently, the OCC has interpreted the Congressional mandate "... to require the use of its authority when examining banks ..." (emphasis added), to require the use of its authority when supervising banks. That interpretation underlies its view of its CRA responsibilities

### Outline of Report

The OCC activities designed to meet its CRA responsibilities can be classified in terms of the broad requirements found in the law. The OCC encourages national banks to meet local

community credit needs through its examination and corporate application processes and through a number of other activities designed to increase the sensitivity of national banks to CRA-related issues and community lending opportunities.

Activities to encourage national banks to meet community credit needs are described in the next section. They include OCC initiatives to meet with bank customer groups, sponsor programs for bankers and community leaders, issue advisories on bank responsibilities to local communities, participate in programs initiated by bank customer groups, and encourage bank investments in community development corporations and community development projects.

Section III describes how the OCC has prepared itself to assess the CRA performance of national banks and encourage them to help meet community credit demands through the examination process. It covers OCC examination priorities and policies, examination programs, the training of examiners, and the resulting CRA ratings of national banks.

Section IV describes how the OCC uses CRA ratings and other relevant material in evaluating corporate applications subject to CRA. Topics covered include OCC procedures for public comment, the use of data compiled pursuant to the Home Mortgage Disclosure Act (HMDA), and the disposition of corporate applications since 1981.

Section V addresses the CRA compliance-related issues such as the public disclosure of CRA ratings, the expansion of HMDA reporting requirements to include small businesses, and the possible impact of securitizing mortgages on CRA compliance by national banks.

Section VI contains a summary and conclusion.

## II. ACTIVITIES TO ENCOURAGE BANKS TO MEET COMMUNITY CREDIT NEEDS

In the examination process, the OCC encourages banks to help meet community credit needs through examiner discussions and recommendations to bank management. Through its Customer and Industry Affairs Division, the OCC provides encouragement to banks via an ongoing program of activities to help facilitate increased banking industry sensitivity to customer and community needs. This is accomplished through (1) OCC-initiated meetings with customer groups; (2) OCC-sponsored conferences and publications on community lending and CRA issues; (3) OCC issuances; (4) participation by OCC senior management and staff at meetings sponsored by banking and bank customer groups; and (5) the OCC's Community Development Corporation (CDC) Program.

### Meetings with Bank Customer Groups

The OCC coordinates activities to increase interaction among the Office and consumer, community, and other groups, to monitor CRA issues, and to offer feedback to the banking industry. In

1985, the OCC's Customer and Industry Affairs Division, in concert with District Offices, conducted "Bank Customer Group Key Issues Meetings" in each of the OCC's six districts. The purpose of the meetings was to discuss a broad range of CRA, consumer, housing, and small business issues and concerns and obtain customer group perspectives on bank and OCC performance. "Summary Reports" for the meetings were developed and provided to all national banks, customer groups in each district, key OCC policymakers, and other federal financial regulatory agencies.

To obtain a broader, national perspective, the OCC arranged a "National Bank Customer Groups Key Issues Meeting" in April of 1986. That meeting brought together the Comptroller, senior OCC management, and representatives of nationally based bank customer groups for a dialogue on banking issues that affect consumers, small businesses, and community, civil-rights, housing, and state- and local-government organizations. A comprehensive summary of that meeting, which included a discussion of concerns national groups raised about CRA regulation and bank performance, and OCC responses to those concerns, was provided to all national banks, national customer groups, bank trade associations, and other regulatory agencies.

In 1987, the OCC implemented a process under which District Offices conduct their own community outreach and contact programs to elicit customer group perspectives on bank performance under the CRA and other consumer compliance laws.

Information collected through these outreach programs is utilized during the CRA assessment process and in District Office communications on compliance issues with banks.

#### OCC-sponsored Conferences and Publications

The OCC sponsors conferences and roundtables for bankers on issues related to community lending. One of the primary purposes of these meetings is to develop and provide information to national banks about the successful approaches banks have used in meeting community credit needs. In each case, a publication based on the proceedings of the meeting has been provided by the OCC to national banks. Over the last few years these conferences have included:

- o "Small Business Lending and Private Secondary Markets". A 1984 roundtable, cosponsored with the National Federation of Independent Business (NFIB), highlighted innovative bank programs to make available long-term, fixed-rate financing to smaller businesses. The purpose of the program was to educate bankers and leaders in the public and private sectors about opportunities and new approaches in small business finance and to encourage them to work together to implement creative long-term financing programs. It

addressed new developments in the lending field with banks serving both as loan originators and as sellers of loans to other investors with long-term investment horizons, such as pension funds. Approximately 50 leaders from the banking, small business, and governmental sectors participated in the meeting. A publication based on the roundtable was written and provided to over 2,000 national banks.

- o "The Changing Shape of Retail Banking: Responding to Customer Needs", a major national conference, was held in June 1985. Over 220 people attended including bankers, community, consumer and small-business leaders, and bank trade association representatives. The goal of the meeting was to help participants adapt to change and understand the evolving role of the bank customer. It was also meant to assist the OCC in understanding the concerns and needs of the industry and customer groups. Senior OCC officials and guest speakers discussed the importance of understanding customer needs. Four conference workshops, with bank and customer group speakers, included "Branch Banking in the Eighties", "Responding to the Small Business Market", "Initiatives in Low-Cost Banking and Consumer Education", and "Community Investment: A Market

Development Strategy". A Conference publication was made available to bank customer groups and banking organizations. It was sent to approximately 1,500 national banks.

- o "Opportunities and Issues for Banks in Affordable Housing" was the subject of a roundtable sponsored by the OCC in December 1986. The purposes of the roundtable were to heighten the awareness of bankers regarding opportunities for investment in affordable housing programs and highlight several effective financing programs offered by banks or through partnerships in which banks participate. The roundtable attracted more than 100 participants, the great majority of whom were bankers. Three panels addressed innovative approaches for bankers, others in the private sector, and governmental bodies to work together to provide housing for low- and moderate-income people. Some of the models discussed included bank community development corporations, the Chicago Equity Fund, the Local Initiatives Support Corporation, the Enterprise Foundation, and the Boston and Baltimore Housing Partnerships. A publication summarizing the proceedings was sent to over 3,000 national banks and other interested parties.

Additionally, in 1987 the OCC published and distributed The Directors' Book: The Role of a National Bank Director. That publication outlines the responsibilities of national bank directors and highlights areas of particular concern. A major section entitled "To Ensure that the Bank Serves the Credit Needs of the Community" is intended to remind bank directors of their banks' CRA obligations and encourages them to take an active role in developing and reviewing bank CRA-related initiatives.

#### OCC Issuances

Additional encouragement is provided to national banks through the issuance of banking circulars that alert banks to common issues and compliance concerns affecting national banks that the OCC has noted through examinations or through its outreach and monitoring activities. CRA-related issuances have included:

- o Banking Circular 189, "Branch Closings and Reductions in Service", which encouraged national banks to develop and implement policies for branch closings to minimize adverse effects on the bank's community;
- o Banking Circular 206, "Basic Banking Services", which encouraged national banks to provide basic banking

services to their customers, including low- and moderate-income, young, and retired persons who may be unable to pay regular charges for conventional banking accounts.

Additionally, the Office provided assistance to the American Bankers Association in developing a Branch Closings Manual, which was designed to help banks make informed decisions when branch closings appear necessary.

#### Participation in Conferences and Programs

The OCC participates at conferences and other meetings and provides ongoing assistance to banking organizations, customer groups, and other interested parties to help them develop and implement informational programs and prepare publications that are related to the CRA compliance responsibilities of banks and to bank participation in special community financing programs. Over the last few years those activities have included the following.

- o The Comptroller, senior OCC managers, and other OCC staff have addressed numerous conferences and workshops sponsored by the American Bankers Association, the Independent Bankers Association of America, the Consumer Federation of America, the National Bankers Association, the National Training and Information Center, and other organizations.



- o The OCC, as a member of the Executive Committee on Government/Business Small Business Capital Formation regularly provides assistance to the Securities and Exchange Commission in planning its annual Small Business Forum. In 1987, the SEC Forum focused on models and approaches used to provide equity and long-term financing for small businesses and included a number of bank-sponsored model programs.
  
- o Each year, the OCC responds to requests from bank customer organizations to participate at conferences and to provide informational materials that address banks' CRA obligations and bank participation in community financing programs. Such assistance includes the provision of OCC speakers and informational materials and advice on bank programs and speakers that could be featured. In November 1987, the Comptroller addressed a major conference sponsored by six national customer groups, "Community Rights and the Banking Industry", emphasizing the importance of the CRA and the OCC's activities designed to encourage bank performance and accountability. Other organizations assisted in 1987 were the National Council for Urban Economic Development, the National League of Cities, the Southern Growth Policies Board, the Black Business Investment Board of Florida, the National Center for

Policy Alternatives, the National Training and Information Center, the National Congress for Community Economic Development, and the Consumer Federation of America.

OCC's Community Development Corporation Program

Bank community development corporations and community development investments are tools that can help banks meet community credit needs. In 1978, the OCC formalized its Community Development Corporation Program, which allows national banks to make direct equity and other investments in community development corporations (CDCs), business ventures, or community development projects serving predominantly civic, community, or public purposes.

In 1984 the Office issued Banking Circular 185, "Community Development Corporations". The Circular describes the OCC's policies, procedures and guidelines for national banks wishing to organize or invest in CDCs or invest in community development projects.

During 1987, over 125 inquiries were processed from parties interested in establishing CDCs. To date, 39 national bank CDCs have been approved by the OCC. A number of these CDCs have multiple bank investors. Almost 100 banks have invested in CDCs

er community development projects under the OCC's program. National bank CDCs and community development investments have focused on housing development and rehabilitation, downtown and neighborhood commercial revitalization, industrial development and redevelopment, small and minority business assistance, neighborhood marketing, and the provision of training, technical assistance, research, and planning for nonprofit development groups.

1987 CDC activities by the OCC included the following:

- o CDC information package. This package, entitled "Community Development Corporation Program for National Banks", was designed to provide national banks and others with important information on OCC's policies and procedures governing bank community development investments and to encourage banks to consider such investments as part of their overall program to help meet community credit needs. The package included five separate pieces of information. Distributed initially in March 1987, the package was used extensively by the OCC throughout the year to respond to banker requests for information about CDCs and community development investment options. In addition, upon request, the

package or individual pieces, were provided to customer groups, federal, state- and local-government agencies, and a variety of customer groups and bank trade associations for use at their conferences and other programs. To date, over 4,500 packages have been distributed. The information pieces in the package included four brochures:

- oo "National Bank Community Development Corporations and Community Development Investments",
- oo "Community Development Corporation Program Questions and Answers",
- oo "National Bank Community Development Corporations: Directory",
- oo "National Bank Community Development Corporations: Background Information",

and a copy of Banking Circular 185: "Community Development Corporations".

- o CDC exhibit. The OCC prepared and presented an exhibit on national bank CDCs at the ABA's Real Estate Finance

Conference held in March 1987. The exhibit helped distribute the CDC information package and explain the benefits of CDCs to many of the 350 bankers who attended the conference.

- o Financial Institutions' Community Development Corporations Forum, August 13, 1987 in Washington, D.C. To promote bank and bank holding company community development corporations, the OCC, together with the Board of Governors of the Federal Reserve System, convened this forum to provide information about bank-related CDCs and community development investments. The Forum was attended by over 200 individuals, including current CDC officials, bank and bank holding company representatives, and others interested in CDCs. The Forum included information on how to form a CDC, highlighted new and innovative housing and small business development approaches of current CDCs, and explained the OCC's and the Federal Reserve's CDC approval procedures.

All exhibits referenced in this section have been assembled in Appendix 4.

### III. DEVELOPING EXAMINATION RESOURCES TO ASSESS AND ENCOURAGE CRA PERFORMANCE

The OCC has experimented with a number of ways to meet its responsibility to assess the CRA performance of national banks and to encourage them to respond to community credit demands through the examination process. This section details OCC efforts to develop the resources to meet that responsibility. It describes the changing nature of CRA examination programs and examiner training, as well as OCC judgments about compliance with CRA by national banks.

#### Early CRA Examination Priorities and Policies.

The OCC began giving special emphasis to consumer compliance in 1974. At that time it created the Consumer Affairs Division, which was responsible for coordinating all complaints and examination-related activities in the area of consumer protection. Its activities included monitoring the training of consumer examiners and developing their examination tools and procedures, including the Comptroller's Handbook for Consumer Examinations, first published in September, 1977.

With the enactment of the Community Reinvestment Act in 1978, the law's requirements quickly became part of the previously established consumer examination program at the OCC. The implementing regulation (12 CFR 25, promulgated in October 1978) was added to the Comptroller's Manual for National Banks. After more than a year of field testing by OCC consumer

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examiners, examination procedures were added to the Handbook for Consumer Examiners. Also added to the Handbook in 1979 were a chapter explaining the requirements of CRA and a series of questions and answers designed to make banks aware of their CRA responsibilities.

The OCC formally initiated separate consumer compliance examinations in 1977 and intensified training programs to ensure the availability of the requisite personnel. From 1977 to mid-1981, all consumer-trained examiners participated in an intensive, sequestered two-week national school. Comprehensive instructions on CRA assessment and the examination process were taught. On-the-job training was also required after completion of the school. Most of those examiners performed consumer examinations exclusively for at least six months.

Experience showed that the initial intensive approach to consumer examinations required a substantial commitment of resources from both OCC and all banks. The benefits of added compliance that were achieved for those national banks that needed to improve their record of compliance did not justify that commitment. A different approach was needed--one that could ensure a high level of compliance by all national banks, but at the same time make more efficient use of agency and bank resources by focusing on those banks in greatest need of improving their performance. Additional incentive to develop a more efficient approach was provided by OCC senior management,

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who wished to contribute to an Administration effort to reduce regulatory burdens in the marketplace.

In 1982, the OCC implemented a new approach to both commercial and consumer examinations that involved a two-tiered integrated examination. Both compliance with the law and the pursuit of safe and sound banking practices by each national bank were to be judged initially in terms of the quality of the operating procedures used by each national bank. If weaknesses were found, a more intensive examination procedure was to be employed, targeted at areas of weakness. In addition, commercial and consumer examination procedures were integrated. OCC training objectives were subsequently changed to reflect the change in supervisory goals.

In mid-1983, as the Office undertook efforts to use its limited resources more efficiently, consumer compliance training was transferred to the district level. A self-study course was made available to all examiners, and, depending on resources, a classroom course was conducted to supplement self-study and on-the-job training.

Full and continuing implementation of these procedures was impaired by unanticipated and substantial increases in the number of banks requiring special supervision, the number of bank failures, and the resulting pressures on the federal deposit insurance fund. Examiner resources that the OCC had originally believed would be available for full implementation

of the modified consumer examination procedures had to be diverted to assessment of the safety and soundness of national banks. Against this background, the OCC made further adjustments to its consumer compliance efforts.

#### Current Examination Programs

The current Compliance Program, designed in 1986, was made fully operational in 1987. Under the Program, examiners initially assess compliance by evaluating a bank's procedures and policies designed to ensure adherence to a number of laws and regulations. They include the Bank Secrecy Act, the Community Reinvestment Act, fair lending laws, such as the Equal Credit Opportunity Act and the Fair Housing Act, insider transactions, consumer protection laws, such as the Truth in Lending Act, adherence to fiduciary principles in the performance of fiduciary powers. The operation of electronic data processing centers and bank dealer activities are also examined. The heart of the program is the selection of a stratified random sample of national banks for an in-depth review of their compliance efforts and accomplishments. The uncertainty associated with being selected in the sample provides an incentive for compliance.

The first component of the Compliance Program is to conduct thorough and consistent examinations of a stratified random sample of banks and provide reports to bank directors and management on their CRA performance. National banks with over

\$1 billion in assets, of which there were 204 as of September 30, 1987, are examined every two years. The other 4442 national banks with under \$1 billion in assets are examined when they are selected through the sampling process, so the time between examinations will vary. (The sampling is biased toward the larger institutions.) The overall probability of selection for the smaller banks is .16 each year. During the 1987 cycle, over 800 banks were included in the sample of institutions examined under the newly instituted Compliance Program.

Other CRA assessments may be conducted through targeting and special investigations of banks not selected by the sampling procedure. Banks may be selected for CRA examinations, for example, if they are known to be planning an expansion through merger or branching, or if the supervising examiner has discovered unsatisfactory operating procedures through the commercial examination.

The OCC does not have precise information on the amount of time devoted specifically to on-site CRA examinations; its time reporting system categorizes examination time only for consumer compliance generally. However, approximately 20 percent of the time spent on the consumer-protection portion of an on-site compliance examination is devoted to CRA. That figure was used to develop the data presented in the following table, which covers the second and third quarters of 1987.



Estimated On-Site Examiner Time Devoted to CRA Compliance  
March - September 1987

| <u>Asset Size</u> <sup>1/</sup> | <u>Work Days/Bank Examined</u> |
|---------------------------------|--------------------------------|
| Under \$50 million              | 2.5                            |
| \$50 million to \$100 million   | 2.5                            |
| \$100 million to \$300 million  | 3.0                            |
| \$300 million to \$1 billion    | 4.5                            |
| \$1 billion to \$10 billion     | 9.0                            |
| over \$10 billion               | 16.5                           |

1/ Asset size categories used in the analysis of OCC's compliance program. Size categories requested are not available.

The second component of the Compliance Program involves extensive OCC efforts to inform bank management of their compliance responsibilities through the use of banking issuances and advisories. Four advisories, covering a broad spectrum of issues including speculative trading activities, disclosure of the method of calculating interest on deposit accounts (the investable balance issue), banks' investments in government securities mutual funds, and home equity lines of credit, were distributed to the industry in 1987.

More formal banker education is a large part of the OCC's new approach to compliance. In 1987, the OCC, through its Consumer Activities Division, provided speakers for over 30 seminars and training sessions sponsored by trade and state banking associations promoting compliance with consumer protection laws and regulations. Of particular importance in

this education effort was OCC's participation in the American Bankers Association (ABA) "Bank Compliance Symposium", which was televised to over 3,000 bankers and included segments on compliance with CRA and other consumer-protection laws. OCC's Compliance Department staff also participated in ABA's first National Compliance Conference and discussed the Compliance Program and CRA. The Office also sponsored a briefing on the Compliance Program for over 25 leading consumer and community group representatives informing them of the basic components and objectives of the program.

A third component of the Program is the simplification of compliance with regulatory requirements. For instance, a national bank examiner in the Consumer Activities Division developed a microcomputer program that makes it much easier to compute accurate annual percentage rates, in conformity with Federal Reserve Regulation Z. This program was distributed to all OCC examining staff, the FDIC, and the Federal Reserve Board. It is also being distributed to the banking industry through the American Bankers Association. Other computer programs are being developed that will simplify compliance with other regulations.

The fourth component of the program will be the development of off-site evaluation techniques. With the completion of the first cycle's compliance examinations in April of this year, we will analyze the examination data to determine if there are certain characteristics that may indicate the quality of

compliance performance. If that effort proves fruitful, the OCC may be better able to allocate its resources to address more efficiently and effectively potential problem areas.

Finally, we will deter noncompliance throughout the national banking industry by taking appropriate action to correct detected problems. The OCC believes that these efforts comprise a program that efficiently and effectively promotes compliance with CRA and other laws and regulations.

A special program for multinational banks. A project undertaken prior to the full implementation of the new Compliance Program added materially to its current scope. In the fourth quarter of 1986, the OCC conducted extensive CRA examinations in each of the multinational banks and seven of their affiliate banks. That effort involved background meetings between OCC staff and community representatives, both in Washington and in the cities in which the banks are located, for the purpose of alerting examiners to the concerns of community groups. Community profiles on the seven cities in which the multinational banks are located were also developed, with the assistance of the OCC's Customer and Industry Affairs Division.

Continuing dialogues with the managements of the multinational banks contributed to additional improvements in the OCC's Compliance Program. Currently, the OCC seeks to ensure that bank Boards of Directors are fully informed of

the examiner's findings and requires detailed information on corrective actions undertaken to monitor their effectiveness. When the banks that have received less than satisfactory ratings make corporate applications, the OCC will require them to (1) take appropriate action to correct cited problems; (2) provide detailed reports on improvements to CRA performance; and (3) provide an account of CRA accomplishments made since the most recent examination.

#### Current Examiner Training

Under our current Compliance Program, each examiner is trained to conduct CRA assessments as part of broader compliance examination training. Compliance training typically occurs after the examiner has been with the Office for between 12 and 30 months, depending on the availability of district resources.

Additionally, a revised consumer compliance self-study course has recently been piloted and will be distributed to the districts in the first quarter of 1988. The OCC is also implementing a 40-hour tutorial, produced by the ABA and OCC staff, on consumer-protection laws and a consumer school that will be held in the districts. The participants will be tested at the conclusion of the school, identifying those who require monitoring by field managers to overcome deficiencies. The new curriculum including preliminary reading, time in class, and testing will take from three to four weeks to complete.

An advanced consumer compliance seminar is also offered to commissioned national bank examiners who have completed the district-sponsored consumer school and who will be conducting the consumer portion of compliance examinations. At the seminar, leaders from holding companies, banks, consumer and community groups, and other financial regulatory agencies offer different perspectives on a variety of consumer-oriented issues including CRA. The OCC is also developing a seminar for managers who administer the examination process in the field and who review compliance examination reports.

#### Examination Results: CRA Ratings

The OCC uses a system of individual ratings that summarizes the examiners' view of bank compliance with CRA objectives. A rating is based on the evaluation of a number of areas, including bank performance under the assessment factors detailed in the CRA regulation, public files of comments from the community on bank performance under CRA, and community contacts made through our outreach programs, as described in Section II of this report.

Banks may be given CRA ratings ranging from 1 to 5. A rating of 3 is given to banks whose CRA performance is less than satisfactory; a 5 rating represents a substantially inadequate record of helping to meet community credit needs. We do not believe that, ~~as a~~ <sup>in</sup> general, a large number of banks should fall into

the 3, 4, and 5 rating categories. In general, banks historically have helped to meet local community credit needs, consistent with safety and soundness requirements, and they continue to do so.

In 1986, 45 national banks had CRA ratings of 3, 4, or 5. Forty-two were the result of examinations conducted that year; three were carried forward from previously conducted examinations. The total number of less than satisfactory ratings represents three percent of the banks that received consumer compliance ratings in 1986. In 1987, 39 national banks, five percent of those that received CRA ratings that year, were rated 3, 4, or 5.

#### IV. CRA PERFORMANCE AND CORPORATE APPLICATIONS

To meet its third requirement under CRA, the OCC considers the CRA performance of national banks when evaluating their corporate applications. Information incorporated into those evaluations is derived from sources described elsewhere in this report, *i.e.*, examinations conducted in the course of the Compliance Program and targeted examinations or special investigations triggered by an application, from data collected under the Home Mortgage Disclosure Act (HMDA), and through public comments.

Opportunities for Public Comment

OCC policies and procedures for the disposition of corporate applications offer extensive opportunities for public comment. These opportunities may be found in certain provisions of our regulation 12 CFR Part 5, "Rules, policies, and procedures for corporate activities".

In particular, section 5.8 requires all applicants to notify the public of its application by publishing a notice in a "... newspaper of general circulation in the community in which the applicant proposes to engage in business. The notice shall state that an application is being filed as of the date of notice, and the notice shall contain the name of the applicant(s) and the subject matter of the application." In addition to the requirement for public notice by the applicant, the OCC publishes a notification of receipt and disposition of applications in its Weekly Bulletin. The Weekly Bulletin is distributed to subscribers within three weeks of the date of receipt or disposition.

Section 5.9 requires the OCC to maintain a public file for each application. The public file contains the application and, with certain exceptions, supporting data and supplemental information filed by the applicant(s). It also contains "... all data and information submitted by interested persons in favor of or in opposition to such application...." Ordinarily,

interested persons are given 30 days after the publication of the notice to provide comment. However, the OCC may extend the comment period, if there are extenuating circumstances.

Section 5.10(b) offers the opportunity for a public hearing. Because the expenses of a hearing to all concerned are substantial, a hearing is granted only if the OCC determines that, "... written submissions would be inadequate or that a hearing would otherwise be beneficial ...." The OCC does not maintain extensive historical records on applications for hearings. However, in the first 11 months of 1987, there were 18 requests for hearings of which 17 were denied. One request for a hearing was granted. It was not held, however, because the parties resolved their differences outside the hearing process.

When applications are protested on CRA grounds, the OCC encourages, but does not require, further communication between the contesting parties. Any agreement they might reach is not subject to OCC approval or enforcement. However, the OCC does consider information on the extent to which a bank adheres to an agreement when assessing its record in meeting the credit needs of its community. We also take into account any negative effects that may result from a bank's decision not to meet with community groups.

The Use of HMDA Data

The Home Mortgage Disclosure Act requires insured commercial banks with a home or branch office in metropolitan statistical areas to maintain and file with the Federal Reserve certain residential mortgage loan data. Those data are intended to reveal the size of mortgage loans and the locations of properties used to collateralize them. OCC examiners take HMDA data into consideration when making their CRA evaluations.

Examiners view HMDA data that indicate a disproportionately low level of lending to low- or moderate-income areas, compared to other areas in the local community, as a warning signal that CRA performance may be inadequate. However, an indication of disproportionate lending patterns would not itself be cause for denial of a corporate application. The examiner would need to investigate further. The bank might be meeting its CRA obligations in other ways. It could, for example, be engaged in commercial lending for multiple-family housing.

In the final analysis, if the OCC did determine that an unreasonable pattern did exist, the corporate application could be denied. However, an approval with conditions might be a more appropriate response.

The Disposition of Corporate Applications

The OCC has found that conditional approval is an effective means of CRA enforcement. It commits the bank to improve compliance, and the OCC's appropriate district office monitors the bank's fulfillment of the conditions. The community benefits through corrective actions taken in response to the OCC's conditional approval. A blanket denial, by contrast, might result in the applicant taking no action. Nonetheless, denials have been and will be used in those cases where no agreement can be reached in the short-term or when the bank is uncooperative.

Protested applications. Since 1981, of the more than 10,000 corporate applications received by the OCC, 38 have been the subject of a CRA protest. Of those 38, 28 were approved without conditions, two were approved subject to conditions not related to CRA, one was withdrawn, and seven are pending. A complete list of those 38 applications is appended to this report.

Corporate applications from banks with adverse CRA ratings. Approximately 80 corporate applications from institutions with CRA ratings of 3 were approved last year. However, in each instance the bank's record of performance was reviewed and it was determined that there were mitigating factors present to lessen the agency's supervisory concerns. Examples of such factors include determinations by the OCC that the bank had satisfied requirements previously dictated by the agency, or



that the bank was making adequate progress towards correcting its CRA problems; that the ratings were attributed to inadequate bank monitoring systems and not a disregard of community credit needs; or with respect to acquisitions in failed or problem bank situations, that the potential adverse effects of the absence of a bank in the community outweighed the agency's CRA concerns.

Since 1986, no applications from institutions with CRA ratings of 5 have been approved. Agency records reflect approvals for one bank that had a CRA rating of 4. In this case, approval was deemed appropriate because of the bank's responsiveness in correcting the CRA problems and additional positive findings during a followup review by the OCC. That review revealed a more extensive advertising and marketing program and a more extensive involvement in community development programs than previously disclosed. In addition, bank management had committed to developing and documenting a systematic program for officers to go into their communities, especially low- to moderate-income areas, and establish a meaningful dialogue with community organizations and leaders regarding the community's credit needs. The bank had begun to hold such meetings with community leaders. This information was available to the OCC during the review of the application. The bank's rating was subsequently upgraded to 3.

Denials. Since enactment of the CRA, the OCC has denied four corporate applications due to CRA factors. That number reflects a weighing of numerous considerations. Many applications seek approval to establish new facilities, such as branches and automated terminals. Denial of such applications could be counter productive. It could restrict the supply of services to the community at large. It could reduce the amount of leverage available to the OCC in its efforts to encourage improved CRA performance.

The OCC believes that conditional approvals are more effective than denials in securing such improvement. Consequently, it has approved at least 23 applications with specific conditions requiring the applicant to strengthen its CRA performance. The OCC action was based on an independent assessment of the applicant's CRA record. The conditional approvals did not involve protested applications.

#### V. OTHER CRA-RELATED ISSUES

##### Public Disclosure of CRA Ratings

Some leaders of community groups have urged federal bank supervisors to make the CRA ratings of individual banks public. Two considerations argue against such disclosure.

First, it is not clear that such release would serve a useful purpose. CRA ratings (like the other summary rating systems used by the banking agencies) serve an important, but limited, purpose for the supervisory agencies. In essence, the rating is the assignment of a quantitative value to the bank examiners' evaluation of a number of qualitative factors. The rating, however, is but a general indicator of a bank's CRA performance. It implies little about specific deficiencies or how the bank is addressing them.

Second, it does not appear that the release of CRA ratings is needed for the purpose of informing the public of a bank's performance in meeting community credit demand. National banks and the OCC maintain files that contain public comments on the efforts of national banks to address community credit needs. Those files are available to interested members of the community to assist them in assessing a bank's CRA performance.

#### Expansion of HMDA to Include Small-business Loans

Appeals have also been made to apply disclosure requirements similar to those of the Home Mortgage Disclosure Act to lending by banks to small businesses. The OCC does not think such a disclosure requirement would be appropriate. In particular, it is unlikely that the benefits of having that information available would justify the costs that would be involved in reporting and compiling it, assuming the disclosure requirements were to mirror those of HMDA.

Lenders would be faced with significant costs to create and maintain the disclosure system. Because small business loans are not a homogenous product like home mortgage loans, the costs are likely to be substantially greater than for the present requirement.

In addition to the burden placed on financial institutions, the burden placed on the banking agencies would undoubtedly be high. Currently, the OCC is required to review approximately 3,000 HMDA disclosure forms. Before those forms are transmitted to the Federal Reserve Board (FRB) for processing into the HMDA Aggregation Tables, each form must be manually edited for errors and assigned a 13-digit identification code provided by the FRB. Each of the six district offices must bring in field examiners to perform this task. It takes 11 field examiners more than two months to complete the editing of HMDA reports. Expanding the disclosure requirements to include small business loans will add significantly to this already resource-intensive task.

No doubt, there would be some benefits of having information on small-business loans. It would be useful in assessing the CRA record of financial institutions, and it could help state and local governments and community organizations to ascertain whether small business lending is an important part of a bank's business. But there are less costly ways of obtaining such data. Interviews with bank management and loan officers and

with small business organizations are one source. Voluntary surveys of businesses and banks are another source--one that would be less costly than nationwide data gathering. Furthermore, a survey tailored to local needs is likely to generate more useful information than one based only on geographic location.

Secondary Mortgage Market Standards and CRA

There have been some expressions of concern that securitizing mortgages and other secondary mortgage market developments might bias extension of mortgages in low-income areas. Although the OCC is aware of anecdotal evidence that banks avoid some lending because of secondary market requirements, it is not aware of any formal complaints alleging that national banks have avoided such lending because of the application of secondary mortgage market standards when underwriting mortgage loans. Nor have any examiners reported compliance violations attributable to that source.

The existence of secondary mortgage market standards do not diminish the responsibilities banks have under CRA; given the anecdotal evidence, the OCC is alert to the possible supervisory ramifications of this issue. Our awareness has been heightened through contacts with community groups and concerned bankers. The topic was discussed at national and regional bank customer group conferences that the OCC convened in 1985 and 1986. In

September of 1987, it was the subject of a highly constructive roundtable, co-sponsored by the American Bankers Association Consumer Issues Task Force and the Association of Community Organizations for Reform Now (ACORN), that involved representatives of community groups, banks, secondary mortgage market players, and the mortgage insurance industry. Representatives of the financial regulatory agencies, including the OCC, attended the roundtable as observers.

Through these discussions we have learned that some bankers and community groups do indeed find that the requirements of secondary mortgage market participants and mortgage insurers are sometimes an obstacle to urban housing lending and the fulfillment of housing investment agreements. According to some bankers, some banks that originate mortgage loans secured by property in urban areas are holding those loans in portfolio because of their inability to sell them in the secondary market.

The OCC has not discussed these concerns directly with the secondary market corporations. In the absence of direct evidence of national bank noncompliance with applicable laws, a regulatory solution would not be an appropriate way to address this issue. Rather, private initiatives, such as the recent ABA-ACORN roundtable, are an appropriate way for interested parties to discuss the issue and explore ways to address their mutual concerns.

VI. SUMMARY AND CONCLUSION

The OCC has developed a comprehensive program to ensure that national banks meet the credit needs of their local community. We maintain extensive contacts with community and banking groups to ensure that all parties understand the needs and resources of each other. We use on-site examination programs designed to ensure that national banks comply with the law. We offer our examiners specialized training to ensure our own ability to assess accurately national banks' compliance efforts and accomplishments. We consider the results of our assessments in evaluating corporate applications and have, at our own initiative, caused national banks to strengthen their CRA performance.

Most national banks meet the credit needs of their local communities in the ordinary course of doing business. The OCC has not found it necessary to deny many applications on CRA grounds--only four since 1979. Denials are a last resort. They are used only when the far more effective tactic of conditional approval has little, if any chance, of modifying bank performance.

Senator GRAHAM. Thank you, Mr. Clarke.  
Mr. Wall.

**STATEMENT OF M. DANNY WALL, CHAIRMAN, FEDERAL HOME  
LOAN BANK BOARD**

Mr. WALL. Mr. Chairman and members of the Banking Committee, it's a pleasure to be here in this role, my first appearance since having been sworn into office last July.

The thrift industry has a longstanding tradition of community based and community related lending and I think as such it has been a focus of some attention of CRA by community groups concerned with CRA, but I think those community groups have not found the agency wanting but have found the agency and its regulated institutions as responsive, for the most part, to their communities. I think that can be attributed to a reflection of the results of the examination process.

**LONGSTANDING TRADITION OF COMMUNITY INVESTMENT**

As you are aware, by virtue of the role traditionally played by savings and loan institutions as the primary provider of home financing, this longstanding tradition of community investment is an important part of their function. I would remind everyone of something that even staff didn't see fit to remind me of but it's something that I have personal experience of back in my days in municipal government. There is within the service corporation statutory authority for the thrift industry a special percentage permitted of additional investment, a larger percentage of their asset size, by virtue of their activity in so-called urban renewal areas. Certainly the urban renewal program is not existent as it used to be and certainly not in the prominence that it once was, but it does give those service corporation entities additional impetus to be involved in community and community-based kinds of activities.

Before the passage of CRA, the Bank Board had established an Office of Housing and Urban Affairs to assist institutions in serving the needs of their communities. After enactment of the CRA, this office was expanded to the Office of Community Investment, OCI as it's called. The Bank Board also appointed a Community Investment Officer, a CIO, at each Federal Home Loan Bank. Through the OCI and the CIO's, the Bank Board has made available to the industry community groups, and State and local officials technical assistance designed to assist thrifts with investment in local communities.

In 1978, the Federal Home Loan Bank System also established a 5-year, \$10 billion community investment fund, the CIF as it was called. This fund, which has expired, provided specially priced advances to thrifts involved in community investment activities. Over 40 percent of the thrift members participated in the voluntary effort that assisted in financing more than 500,000 housing units.

After passage of the CRA, the Bank Board worked with other regulatory agencies to issue implementing regulations. In these regulations the Bank Board incorporated the eleven specific factors the agency identified as necessary for assessing an institution's record in meeting the needs of its community.



Subsequently, the Bank Board issued a memorandum for staff guidance, AB-35, that defined the five CRA ratings and linked an institution's CRA performance to its compliance with the bank board's nondiscrimination regulations.

#### PROCEDURES FOR EXAMINERS AND ONGOING TRAINING

In the wake of the CRA's passage, the Bank Board also issued an extensive procedure for examiners to follow in conducting CRA examinations. On an ongoing basis the Bank Board also included and continues to include CRA training and courses provided to its examiners.

As you are aware, in the early 1980's the thrift industry suffered an interest rate spread crisis. Because of the condition of some insured institutions, the Bank Board at that time had little choice but to devote substantial resources to safety and soundness concerns. Since we were not equipped with an adequate examination staff, we placed a premium on examinations relating to safety and soundness. I regret to report that, as a result of this situation, we did not allocate sufficient resources to the enforcement of the CRA or, for that matter, other consumer-related issues.

In some instances, the district banks carried over existing CRA ratings from one examination to the other. In preparation for these hearings today I have sent an official notice to the Office of Regulatory Policy Oversight and Supervision that they are to direct that the carryover be stopped.

We have also continued to show renewed attention to CRA issues now that the problems of interest rate spread and the so-called asset problems appear to be abating and our resources, on the other hand, are now in hand and are available for us to devote them.

Since early 1986, the Bank Board and the Federal Home Loan Bank System have been working to reemphasize the importance of consumer issues. Several memos issued to district examination and supervisory staff emphasize the importance of the CRA and other consumer protection regulations with particular regard to de novo and newly insured institutions.

#### EXAMINATION AND SUPERVISORY PROCESS

In the past 2 years we have made progress in the examination and supervisory process. We'd like to summarize quickly that process for you.

In the examination area, we believe that CRA compliance can best be achieved through the examination and supervision process rather than through the application process. Consequently, our ability to enforce the CRA in the examination context will be assisted by our recent establishment within the Federal Home Loan Bank System of the Office of Regulatory Policy Oversight and Supervision, or ORPOS, as it's come to be called. Before the Bank Board established ORPOS, we transferred our examiners to the Federal Home Loan Bank System and hired many additional examiners, more than doubling the staff within the last 2 years, providing us with the resources to properly focus attention on CRA examinations.

These resources also allow us to fulfill our commitment to conduct regular examinations of our institutions on an 18-month cycle.

In addition, the Federal Home Loan Bank System has recently established within ORPOS a Division of Compliance Programs. It is the Compliance Division's responsibility to develop uniform examination and supervisory policies and procedures for the enforcement of consumer protection regulations and to establish a program to oversee implementation of these procedures.

As far as training is concerned, in recent years of the examiners who have attended the new examiner training school, or NETS as it's called, 90 percent have been trained in examining financial institutions for compliance with the CRA. Because of our strengthened examination forces we are completely revising our new examiner training school. A revised section addressing CRA examinations will be included in the training materials and CRA examination procedures will be covered during the actual training sessions.

At the industry level, several of our district banks have been working since October with the Federal Reserve Banks to provide training for member banks and institutions concerning CRA compliance.

The Bank Board has issued a policy statement encouraging the Federal Home Loan Banks to adopt voluntarily a system similar to the Community Investment Fund system of specially priced advances for thrifts involved in community investments. Three banks voluntarily continued the program after the expiration of the central fund and three other banks have recently established a similar program.

The Bank Board has recently increased its activity in the area of CRA after a long lull. There is still much work to be done. As already noted, we are heightening our examiner training process. In addition, the ORPOS Compliance Division will seek ways to assist the industry in achieving compliance on its own through the establishment of internal policies and procedures and through programs to enable the industry to monitor its compliance more effectively.

Further, that division and OCI will continue to participate in educational sessions for industry groups. We believe we have come a long way in the past 2 years and hope and intend that our efforts will enable us to enforce the CRA more vigorously in the future.

[The complete prepared statement by M. Danny Wall follows:]

Statement of  
W. Danny Wall, Chairman  
of the Federal Home Loan Bank Board  
Before the  
Committee on Banking, Housing and  
Urban Affairs  
U.S. Senate  
March 23, 1988

Mr. Chairman and members of the Committee, it is a pleasure to appear before you this morning to discuss the Federal Home Loan Bank Board's ("Bank Board") experience in regulating the lending activities of thrifts under the Community Reinvestment Act of 1977, Pub. L. 95-128 ("CRA"). Inasmuch as we recently submitted detailed answers to your specific written questions concerning our enforcement of the CRA, I would like to provide you, at this time, with a more general statement of the Bank Board's perspective on the CRA and community lending.

Longstanding Tradition of Community Lending

As you are aware, the thrift industry, by virtue of its role as a primary provider of home finance, has had a longstanding tradition of community investment. The Bank Board has encouraged the institutions we regulate to maintain this tradition and to continue to increase local investment. We believe that the CRA is a valuable tool for determining whether an institution is endeavoring to meet the credit needs of its community.

Before passage of the CRA, the Bank Board had established an Office of Housing and Urban Affairs to assist institutions in serving the needs of their communities. After enactment of the CRA, this office was expanded into the Office of Community

Investment ("OCI"). The Bank Board also appointed a Community Investment Officer ("CIO") at each Federal Home Loan Bank. Through the OCI and CIO's, the Bank Board has made available to the industry, community groups and state and local officials technical assistance designed to assist thrifts with investments in local communities. In 1978, the Federal Home Loan Bank System also established a 5-year, \$10 billion Community Investment Fund ("CIF"). This fund, which has expired, provided specially priced advances to thrifts involved in community investment activities. Over forty percent of our thrift members participated in this voluntary effort that assisted in financing more than 500,000 housing units.

After passage of the CRA, the Bank Board worked with the other regulatory agencies to issue implementing regulations.<sup>1/</sup> In these regulations, the Bank Board incorporated the eleven specific factors the agencies identified as necessary for assessing an institution's record in meeting the needs of its community. Subsequently, the Bank Board issued a memorandum for staff guidance, AB-35, that defined the five CRA ratings and linked an institution's CRA performance to its compliance with the Bank Board's nondiscrimination regulations.<sup>2/</sup>

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<sup>1/</sup> 12 CFR Part 563e.

<sup>2/</sup> 12 CFR Part 528.

In the wake of the CRA's passage, the Bank Board also issued an extensive procedure<sup>3/</sup> for examiners to follow in conducting CRA examinations. On an ongoing basis, the Bank Board also included, and continues to include CRA training in courses provided to its examiners.

#### Decline of CRA Enforcement

As you are aware, in the early 1980's the thrift industry suffered a crisis. Because of the condition of some insured institutions, the Bank Board had little choice but to devote substantial resources to safety and soundness concerns. Since we were not equipped with an adequate examination staff, we placed a premium on examinations relating to safety and soundness.

I regret to report that, as a result of this situation, we did not allocate sufficient resources to the enforcement of the CRA, or, for that matter, other consumer-related issues. In some instances, the district banks "carried over" existing CRA ratings from one examination to the next.

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<sup>3/</sup> BOP 123/2c.

#### Renewed Attention to CRA Issues

Since early 1986, the Bank Board and the Federal Home Loan Bank System have been working to reemphasize the importance of consumer issues. Several memos issued to district examination and supervisory staff emphasized the importance of the CRA and other consumer protection regulations with particular regard to de novo and newly insured institutions. In the past two years, we have made progress in the examination and supervisory process. We would like to summarize that progress for you.

##### 1. Examination

We believe that CRA compliance can be best achieved through the examination and supervision process rather than through the application process. Consequently, our ability to enforce the CRA in the examination context will be assisted by our recent establishment within the Federal Home Loan Bank System of the Office of Regulatory Policy, Oversight and Supervision ("ORPOS").

Before the Bank Board established ORPOS, we transferred our examiners to the Federal Home Loan Bank System and hired many additional examiners, more than doubling the staff within the last two years and providing us with the resources

to focus proper attention on CRA examinations. These resources also allow us to fulfill our commitment to conduct regular examinations of our institutions on an 18 month cycle.<sup>4/</sup>

In addition, the Federal Home Loan Bank System has recently established, within ORPOS, a Division of Compliance Programs. It is the Compliance Division's responsibility to develop uniform examination and supervisory policies and procedures for the enforcement of consumer protection regulations and to establish a program to oversee implementation of these procedures.

##### 2. Training

In recent years, of those examiners who have attended our New Examiner Training School ("NETS") 90 percent have been trained in examining financial institutions for compliance with the CRA. Because of our strengthened examination forces, we are completely revising our NETS. A revised section addressing CRA examinations will be included in the training materials and CRA examination procedures will be covered during the actual training sessions.

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<sup>4/</sup> S.P.-69.



At the industry level, several of our district banks have been working since October with the Federal Reserve Banks to provide training for member banks and institutions concerning CRA compliance.

3. Other

The Bank Board has issued a policy statement encouraging the Federal Home Loan Banks to adopt voluntarily a system similar to the CIF system of specially priced advances for thrifts involved in thrift investments. Three Banks voluntarily continued the program after the expiration of the fund and three other Banks have recently established a similar program.

Areas for Improvement

The Bank Board has recently increased its activity in the area of the CRA after a long lull. There is still much work to be done. As already noted, we are heightening our examiner training process. In addition, the ORPOB Compliance Division will be seeking ways to assist the industry in achieving compliance on its own through the establishment of internal policies and procedures and through programs to enable the industry to monitor its compliance more effectively. Further, that Division and OCI will continue to participate in educational sessions for industry groups.

We believe we have come a long way in the past two years and hope and intend that our efforts will enable us to enforce the CRA more vigorously in the future.

Federal Home Loan Bank Board  
OFFICE OF THE CHAIRMAN

M. DANNY WALL, Chairman



1700 G Street, N.W.  
Washington, D.C. 20002  
Federal Home Loan Bank System  
Federal Home Loan Mortgage Corporation  
Federal Savings and Loan Insurance Corporation

January 25, 1988

Honorable William Proxmire  
United State Senate  
Washington, D.C. 20510

Dear Senator Proxmire:

I am pleased to respond to your letter of October 22, 1987 regarding the Federal Home Loan Bank Board's enforcement of the Community Reinvestment Act and CRA-related protests of the applications. Before I respond to the specific questions in your letter, I would like to provide some information to put the answers in the proper perspective.

As you know, the Federal Home Loan Bank System's enforcement effort has undergone radical changes in the last several years. Because of the condition of some of the insured institutions, we have needed to devote substantial resources to the very high priority concerns of safety and soundness examinations and supervision. The System was not equipped to adequately address those concerns and as a result we have hired many additional examiners, more than doubling the staff within the last two years. This newly-hired staff needed to be trained and assimilated into our examination program. While we believe we have made substantial strides in improving and enhancing our examination resources, we are not yet at the point that we would like to be. Thus, I believe it is fair to say, as I have indicated before, that we have not in the recent past devoted sufficient resources to the enforcement of the Community Reinvestment Act, or other consumer-related issues.

We are endeavoring to correct this situation, however. The Board and the Federal Home Loan Banks have recognized the need for greater emphasis and consistency among the Banks in enforcing statutes like the Community Reinvestment Act. To

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this end, we have established within our Office of Regulatory Policy, Oversight and Supervision a Division of Compliance Programs. It is this Division's responsibility to develop uniform examination and supervisory policies and procedures for the enforcement of the consumer protection regulations and to establish a program to determine that such policies and procedures are well implemented. In addition, the Division will be seeking ways to assist the industry in achieving compliance on its own. The Division will participate in more educational sessions for industry groups and plans to develop programs that will enable the industry to more effectively check its own compliance. We have just begun to staff the Division, but I am confident that within a year we will have improved compliance programs well underway.

I would like now to address the specific questions that you have raised in your letter. For convenient reference, the question is cited in bold type and our answers follow each question.

Since enactment of the CRA, how many applications have been denied solely or substantially due to CRA factors? What percentage of total applications processing subject to the CRA does this represent? Does this rate of denial adequately enforce compliance with CRA, or would increased use of the sanctions provision strengthen compliance?

Since the enactment of CRA, the Federal Home Loan Bank System has denied one application using CRA as the basis. While we recognize that this is a small number, we believe that there are a number of factors which tend to support the small number of denials. First, as will be discussed later in this letter, most of the institutions have been judged to have satisfactory or better CRA records, based upon the examinations of those institutions. Thus, in a typical application, the most recent examination of the applicant will reflect at least a satisfactory CRA record thus negating Board concern about its CRA performance.

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Senator GRAHAM. Thank you, Mr. Wall.

I have questions which the chairman has requested be asked and then I would call on Senator Bond for his questions and then I would like to ask some questions that I have generated.

This is a question for all of the panel. Approximately 97 percent of all lenders have received satisfactory CRA ratings. At yesterday's panel, the Consumer Advisory Council concluded that the five-tier rating system has dissolved into a pass-fail system where all but the worst pass.

#### USE OF RATING SYSTEM TO PROMOTE IMPROVEMENT

If CRA is meant to encourage, how do you use the rating system to promote improvement? Do you have any carrots, if you're not using sticks such as low ratings and application denials? Finally, shouldn't you require a clear statement to the lender of what improvement is needed, a report from the lender of how these improvements will be achieved, and agency monitoring?

Ms. Seger.

Ms. SEGER. The statistics do look exactly as you pointed out. The largest number of grades are a two for our own shop, which is all I can comment on specifically.

Senator GRAHAM. What percentage of your grades are one, two, three, four, five?

Ms. SEGER. In 1986, which is the last full year for which I have information, 88 percent of the institutions got a two. These are round numbers. About 9 or 10 percent got a one. The rest got threes or fours. There were no fives in that year. One is best and five is lowest.

Senator GRAHAM. So 98 percent received either a one or two?

Ms. SEGER. Right, but with the dominant group earning a two.

I think you can interpret that a number of ways. One way is to say that the banks we deal with—we regulate about 1,100 State member banks—are doing a reasonably good job in meeting the communities' credit needs. I think that's one interpretation.

Speaking as a former professor, another interpretation you might put on it is that we're easy graders and give all the students A's and B's. I don't think that's the case, but that is a possible interpretation.

A third one would be that we really do take our examination process seriously and that we really do work with the individual institutions that have less than a terrific performance to improve it.

The examination process ends with an examination report. This is true on safety and soundness exams as well as compliance exams. When you write up in the report what the deficiencies of that organization happen to be, in the compliance area or any other area, the hook is that you expect the management and the board of directors to deal with these shortcomings across the board.

And typically, after the exam goes to the management or the directors, then they will have to come back and report how they intend to deal with all the shortcomings and all the weaknesses that are pointed out.

We really do use these grades to determine how frequently we go in for on-site visitations. If you get, let's say, a top grade, then we're going to go in and pay you a visit maybe every 18 or 24 months. If you're one at the lower end of the scale and have glaring deficiencies, we're going to pay you more frequent visits, as often as once every 6 months. Again, the emphasis is on getting your situation improved. Rather than just kicking you out of school because you flunked the course, we want to give you tutorials to keep you there. And I think that's the fair interpretation of how it works. I think that there's way too much emphasis on this distribution of specific grades of one, two, three, four and five.

Senator GRAHAM. Mr. Seidman.

Mr. SEIDMAN. Well, I would support everything Governor Seger has said. Our numbers are very comparable to hers. We, too, work to find a way to get satisfactory compliance. As we understand the law, the banks have to comply and, therefore, if 98 percent of them are complying, it seems to me that that is achieving the purpose of the law. We have had very few complaints in this area.

Senator GRAHAM. Do you think it would be preferable just to have a pass-fail system, a yes-no, rather than five grades?

Mr. SEIDMAN. Well, I think for our own use the system that we now have of a one to five rating system is useful to us for the reasons that Governor Seger has said, to help us spotlight where we need to do more work.

I think as far as a law that has been passed that says did you comply or not, we certainly would think a pass-fail system would be appropriate.

Senator GRAHAM. Mr. Clarke.

Mr. CLARKE. Senator Graham, there obviously are a lot of questions embodied in that one question. I would just say that if you put too much emphasis on the percentage of banks that are rated one or two, it tends to lead one to the conclusion that maybe you should be grading banks on a bell-shaped curve, and I don't think that's the case. You're not really trying to compare a bank's performance against the very best performer in the class, to continue the classroom analogy that Governor Seger used. You're really trying to determine, as the statute mandates, whether the bank is helping to meet the credit needs of the community.

Some banks are going to be superstars in that area and others are going to be marginal players, but they nonetheless are going to be helping to meet the credit needs of their community. So I think that approach can accommodate a large number of banks within the satisfactory performance area, which is our one- and two-rated categories.

Embodied in your question was the extent to which we use the rating to bring about corrective action. As I indicated in both my written statement and my verbal comments, we do deny applications. More frequently, however, when we find unsatisfactory performance, we conditionally approve an application. That means that we ask the bank to take some affirmative action, some specific steps that we can verify, in conjunction with the approval of an application. By doing so, we are effective in bringing about corrective action where we find significant deficiencies.

Senator GRAHAM. Mr. Wall.

Mr. WALL. Senator Graham, the thrift industry completed reports last year—we completed just under 2,200, and the percentage was roughly the same as that indicated by Governor Seger—98 percent in this case in the one through three category and in the four and five category, the remaining 2 percent.

As Comptroller Clarke has indicated, there are a lot of points and a lot of questions in the one question. A carrot and stick approach—I think that's something that has been the approach or a goal of CRA and HMDA and all of the related legislation from the very beginning, to try to achieve some kind of a balance between the two, and it's something that all of us continue to try to achieve whether it be from the legislative side or whether it be from the executive side as we find ourselves.

I think the possibility in terms of a discussion or a statement to the institution at the completion of the examination as to advice or direction as to what might be pursued by them in order to improve their rating it seems to me is a valuable thought and one that I intend to pursue with some of our examination people.

It seems to me as well the matter of a bell shaped curve or however you want to make the comparison with academia is just not appropriate here because you're not comparing one institution with another institution, you're looking at an institution vis-a-vis a community, which is to say you're comparing apples with the basket in which it's located and it is important I think to recognize that you can't compare one apple in one basket in one part of the country with another apple in another basket in another part of the country. This is the best kind of analogy that comes to mind as to what it is we're trying to do. We are trying to grade in a sense is the acceptability of a system or is that apple acceptable in relation to the basket in which it finds itself being placed? That is the kind of comparison that we are looking for.

Senator GRAHAM. Senator Proxmire's time has expired. Senator Bond.

Senator BOND. I thank the acting chairman for the evenhandedness with which he has cut off the committee chairman and commend him on that. [Laughter.]

I would follow up with some questions along the lines that he had and address these generally to the panel as well.

#### PUBLIC DISCLOSURE

Do any of you think, as suggested by several witnesses yesterday, that public disclosure of the CRA ratings would be useful and helpful? Would it put more pressure on those who may be ranking three and four? Would it be a useful tool for consumers to have in making their decisions as to the institutions with which they work do business?

Ms. SEGER. I understand that that was certainly a point brought out yesterday by some of the community groups, but I think that the proposal is based on a misperception of what these numerical grades are. As I tried to indicate, these are basically a shorthand way we have of categorizing performance of these various institutions and it's not a perfect system. Again, speaking as someone who's done a lot of grading, there's a lot of subjectivity involved



and I just would be very reluctant to see the grades disclosed because I think that it would put the emphasis on the wrong thing. The emphasis would be put on the grade rather than on getting good performance in a proactive way.

Senator BOND. Mr. Seidman.

Mr. SEIDMAN. I don't believe it would be helpful to publish grades, if you will, for several reasons. In the first place, I don't really think governmental good housekeeping seals of approval are an effective use of the Government's efforts in this area and many others.

Second, it changes the whole relationship with the bank if they know that you're going to be publishing something. You get into a relationship of vying as to how it will appear to the public. I don't think that that is helpful in achieving the objectives of the statute.

Third, where it becomes an issue, such as an application or transfer, we do at that time give a summary of how the institution has handled their CRA compliance. It seems to me that that is really all that needs to be done in terms of giving a group that has a problem or wants to look at a transfer and so forth a chance to comment on it.

Overall, I think publication of grades would be counterproductive.

Senator BOND. Mr. Clarke.

Mr. CLARKE. I would definitely not be in favor of disclosing the ratings publicly. I certainly agree with Chairman Seidman that it's not appropriate for the Government to become a rating agency for safety and soundness purposes or for CRA compliance or for any other purpose.

Disclosing the ratings publicly could be very misleading, for example, in the case of an institution rated three, less than satisfactory, which in fact was serving the needs of the community but was doing a very poor job of documenting what it was doing. To say that such a bank that was not complying with technical aspects of CRA would be rated a three and have that rating disclosed to the public alongside the three-rating of a bank that was not meeting the needs of the community at all but was papering its files with a lot of irrelevant information in an attempt to comply with technical details to me creates a very misleading comparison. I just think it would be a bad idea.

Senator BOND. Mr. Wall.

Mr. WALL. I would add to that another thought with regard to confusion that would likely or could well occur, and that is, of course, regular examinations use a one to five rating scale that on the bank side is known as the CAMEL rating system and on our side a similar one to five rating system is used. It seems to me there would be a very big risk of people confusing a one to five CRA rating as somehow being reflective of the other health and safety kind of analysis and rating.

As an alternative, something that we're giving much more attention to is being proactive. That is providing for a relationship and interface between the examining force and community groups and encourage examiners to seek out the community groups as they look at not necessarily a given institution in a community, but as they look at the institutions within their jurisdiction. As an exam-

ple, within a particular community in a generic way, to be proactive would be to seek out and to bring about an interface on the examiners' side with those community groups that can be identified, to promote involvement, to encourage interchange, rather than to provide a number which it seems to me has all kinds of inherent and potential problems.

Senator BOND. Another question I would toss up for whoever cares to deal with it, much of the focus it seems to me of the CRA challenges is on home mortgage lending.

#### BUSINESS LENDING AND COMMUNITY INVESTMENT

What role should business lending play in evaluating the financial institution's commitment to community investment? Who would like to handle that?

Ms. SEGER. I'll bite on that a little bit, if I may.

Senator BOND. All right.

Ms. SEGER. Well, mortgage lending is very important, there's no doubt about it, and so is it important for people in the community to be able to get loans to close in their back porch or modernize their kitchen or whatever remodeling loans might go for, but that's not the whole community. I think that you also need to take into account the needs of business, big business, and small business. I think you need to take into account the needs of young people to get college loans. You need to think about financing for the local governmental unit, the school district, or whatever.

That's all part of the community and I think it would be a mistake to just focus on one portion of the community. You shouldn't neglect home mortgage lending, but I don't think it should be the whole story either.

Senator BOND. Mr. Clarke, did you want to add something on that?

Mr. CLARKE. A community can have lots of different credit needs. It's very difficult to expect a bank to be everything to everybody within its community. That's one reason I think the statute is written as it is where it says "to help meet the credit needs of the local community." We have financial institutions that specialize in different kinds of lending, that have different strengths and different weaknesses in those areas, and I would hate to see us develop too much of a view that a bank has to provide every possible kind of credit that might be desired by every possible borrower within its community. I don't think that's what CRA is about.

Senator BOND. But should they get credit if they're making loans, for example—should that be considered if they are aggressively pursuing the creation of jobs?

Mr. CLARKE. Certainly, they should. In fact, just yesterday we hosted a seminar in our office focusing on lending to small business. One of the points made in the discussion was that lending to small businesses, helping them get started and get the kind of financing that they need, helps create jobs, among other benefits it provides to the community. Business lending definitely should be a factor and is a factor in the standards we use in assessing CRA performance.

Mr. SEIDMAN. If I could just make one comment, I think in this whole area we have to be very careful. Banks are private sector institutions. They're really not public utilities. There may be a great many public purposes that need to find support through lending, which is essentially a governmental purpose—the SBA and others. I think we have to be very careful not to take our private sector banking system and try to have it deal with the kinds of things that are fundamentally governmental social programs. It's a tough decision and we're trying to balance it with this act, but I think we have to keep that in mind.

Mr. WALL. Just one additional item I would add, that should be taken into account is secondary market impact and the participation in the secondary market which is, by definition, perhaps more a function and a factor of larger institutions which tend to be those institutions targeted by community groups. Participation of large institutions, whether it be banks or thrifts, whether it be a secondary market for residential loans or a secondary market for college loans is important to maintaining liquidity and credit availability.

So secondary market activity is another one you can add. The list just goes on and on and the basket gets so big that if you're a lender and you're active in various lending activities, you're involved in affecting that community. It may not be in the very principal frontline activity of being the underwriting lender, but it may be a very important part of the chain that makes it possible for money to be available for that loan.

Senator BOND. I thank the witnesses. Thank you, Mr. Chairman.

Senator GRAHAM. Thank you, Senator.

I'd like to ask a few questions and then when the chairman's time returns again he has some more. [Laughter.]

Could you describe the nature of the standards that you use from the context of are they essentially process standards—that is dealing with the way in which decisions are made—or are they performance standards—that is stating ultimate objectives which you see to be accomplished and monitoring the activities of the institutions against whether those ultimate objectives were attained?

Ms. Seger, how would you categorize the Fed's approach to CRA regulation—process or performance?

#### FED'S APPROACH TO CRA REGULATION

Ms. SEGER. In a word, it's both. What we do is, when the examiner goes in, or the examining crew, they do check what you might call the technical side—whether there's a sign in the lobby that explains the Community Reinvestment Act, if you have a CRA statement, and that would also be in the lobby notice, by the way, you do have to have a CRA statement and it must be available for inspection. So that's something that they can check. They can also check to see if you have in fact properly delineated your market, and that's a factual thing that's easy to look at.

But then, in addition, examiners go to what I would call performance tests and look at what the banks they are really doing. Are they working with community groups? They look at the HMDA reports that show where or how the home mortgages and home im-

Unless questions about the CRA performance of an institution filing an application with a "1", "2", or "3" CRA rating\* are raised by someone on the outside, the Board typically considers such performance to be satisfactory and no CRA objections are raised internally with respect to the application.

Second, if an institution with a less than satisfactory CRA compliance record files an application, it may well withdraw the application because of CRA concerns raised by the Board. If it proceeds with an application in the face of a CRA concern, it risks the potential threat of a denial. While such withdrawals do occur, unfortunately there is no tracking system which would indicate the number of such withdrawals or to what degree they are associated with CRA concerns.

Third, enforcement of the CRA can take place through the applications process by use of conditional approvals. Further information about this method of enforcing CRA in the applications process can be found on page 6 relating to the question about approval of applications with "4" or "5" ratings.

The Federal Home Loan Banks have told us that compliance with CRA is primarily enforced through the examination and supervisory process, instead of waiting for a low-rated institution to file an application in order to deal with the violation. We believe that this is an appropriate approach. CRA examinations should be crucial in determining whether violations exist and working with management to correct them.

\* Under the Board's system, ratings 1, 2, and 3 reflect various levels of satisfactory CRA performance, while 4 and 5 reflect levels of unsatisfactory performance.

How many examinations of regulated institutions that assess CRA compliance are conducted each year? On average, how often is a regulated institution's compliance with the CRA assessed through an examination?

Compliance with CRA is assessed through our regular examination process. Presently, all Federal Home Loan Banks state that they are using our SF Memo #69 in scheduling such examinations. (A copy of this memorandum is attached for your convenient reference.) In essence, SF-69 provides that regular examinations are scheduled for every insured institution every 18 months at the latest. The frequency of examination depends upon the condition of the institution and those institutions requiring more attention receive more frequent examinations. Of course, under this schedule, every insured institution is not examined every year. In 1986, 2068 examinations resulted in the issuance of CRA ratings.

What quantitative and qualitative criteria does your agency use to measure the effectiveness of regulatory enforcement of the CRA? What factors indicate that CRA enforcement has been effective. What factors indicate that CRA enforcement has not been effective?

The System has not adopted any formal qualitative or quantitative criteria to determine the effectiveness of its regulatory enforcement of the Community Reinvestment Act. We do, however, use informal criteria which indicate that the enforcement of CRA may be relatively effective. The two informal criteria are the number of CRA-related consumer complaints and the number of CRA-related protests. For example, in 1986, only 2 complaints were received from consumers regarding CRA activities of institutions. In 1987, 19 such complaints were received. We believe this is a relatively small number of complaints, given the fact that more than 3000 institutions are subject to CRA. (We have analyzed the 1987 complaints to determine whether there may be any particular cause for the increase, i.e., do many complaints come from a single source or are a number of the complaints directed at a particular institution. This is not the case. We attribute the increase in such complaints to the fact that CRA interest is rising generally.)



The second informal criteria that we use to indicate the adequacy of CRA enforcement is the number of protests. Protest activity (including both protests that are deemed to be substantive and nonsubstantive), is as follows: 1979 (4), 1980 (13), 1981 (15), 1982 (1), 1983 (7), 1984 (0), 1985 (3), 1986 (0), 1987 (2). (The two protests raised in 1987 have not yet been decided.) The volume of protests since 1985 is only 5, which is a relatively small number.

How many regulated institutions were assigned CRA ratings of "4" or "5" in 1986? What percentage of total rated institutions received these ratings? Were each of these institutions examined in 1986, or did some ratings rely on previous examinations? On what basis can the low level of "less than satisfactory" CRA ratings be justified?

In 1987, 36 of the institutions examined received ratings of less than satisfactory. This amounts to about 3% of all institutions that received CRA ratings during 1987. In 1986, 59 of the institutions examined received ratings of less than satisfactory. This also equals about 3% of all institutions receiving CRA ratings that year.

In 1986, the ratings assigned were as follows:

| <u>Rating</u> | <u>Institutions<br/>Examined</u> |
|---------------|----------------------------------|
| 1             | 3                                |
| 2             | 95                               |
| 3             | 1911                             |
| 4             | 42                               |
| 5             | 17                               |
| Total         | 2068                             |

It is evident that after a relatively cursory review of the lending activities of some associations, the CRA rating has been brought forward from the previous examination.

The majority of the Federal Home Loan Banks providing input believe that the low level of less than satisfactory ratings is justified and evident in the low level of CRA-related consumer complaints and CRA protests, as discussed in the answer to the previous question.

Have applications for institutions with CRA ratings of "4" or "5" been approved by your agency? If so, how can these approvals be justified?

Yes, approvals have been granted to institutions when a CRA-related concern has been raised by the Board. These approvals, however, are typically conditioned upon the institution correcting whatever concern has been raised relating to CRA. Since 1979, 87 conditional approvals have been granted to institutions. Actual statistics on the number of the 87 conditional approvals that involve CRA-rated "4's" or "5's" are very difficult to obtain, since approvals for these actions have been delegated to the Federal Home Loan Banks. It is very likely that some of the 87 conditional approvals involve "4's" and "5's". It is also possible that "4" and "5" applications may have been approved without conditions. Of course, in some cases applications by unsatisfactorily-rated institutions under CRA may have involved applicants which were merging with a failing institution, therefore, relieving a significant supervisory concern to the Bank Board.

The regulatory agencies have long held the position that individual CRA ratings should not be made public, to protect the confidential relationship between a regulator and the regulated institution. However, the intent of Congress in enacting CRA was that, consistent with safety and soundness, sanctions could be imposed on regulated institutions with inadequate CRA records. The use of public CRA ratings would appear to reward institutions with good ratings and sanction institutions with less than satisfactory ratings. Is there any movement in the direction of public disclosure of individual CRA ratings by your agency?



The Federal Home Loan Bank Board does not disclose CRA ratings to the public nor does it disclose such ratings to the institution itself. This follows the same policy of nondisclosure of other ratings assigned during the examination to either the institution or the public. In 1983, the Federal Financial Institutions Examination Council considered the question of public release of CRA ratings and rejected the proposal. I am attaching a copy of the Council's response to that suggestion. It is our view that the reasoning set forth in that response is still applicable today and thus there are no plans on our part to release CRA ratings to the public.

When regulatory examinations of an institution's HMDA statements show that few or no housing loans are being made in low- or moderate-income areas, and that the volume of loans in these areas is disproportionately low compared to the volume of loans in other areas of the local community, how is this interpreted by your agency? If HMDA records indicate "unreasonable" lending patterns, is this sufficient cause for denial of an institution's application? If not, what steps are taken by your agency to correct the imbalance?

If unreasonable lending patterns are indicated by the Home Mortgage Disclosure Act records, the Federal Home Loan Banks tell us that they would examine the circumstances further to determine the cause. Of course, the mere presence of an unreasonable lending pattern would not be sufficient grounds to deny an application or to raise a supervisory concern, without determining the cause for the lending pattern. For example, investigation could reflect that certain areas of an institution's lending community are unaware of the financing available at the institution. In such cases, we would encourage the institution to expand its marketing efforts. Furthermore, these areas may well be served by other lending institutions who are adequately providing market-priced loans at reasonable terms.

In addition, there may be a legitimate reduced demand for mortgage lending in such areas due to economic factors facing certain sectors of the community during a given period of time, such as substantial layoffs at an industrial plant. If an institution is found to be indulging in discriminatory practices, the examination staff would point out such practices and work to achieve correction.

There is an increasing call by community groups to expand HMDA to include disclosure of small business loans. Given the fact that the CRA assessment criteria specifically includes an institution's small business lending records, would an expansion of HMDA to include small business loans be appropriate?

In our view, it would not be appropriate to include the disclosure of small business loans in the HMDA requirement for our institutions. First of all, insured institutions generally do not consider themselves to specialize in small business lending, or in commercial lending of any type to any great degree. To illustrate, in 1986 Federally-insured savings institutions in the aggregate held only 24 of their total assets in the form of commercial loans, which includes small business loans.

There are several technical problems in extending HMDA to include small business loans. One is simply the definition of what is a "small business" and a "small business loan." This question has been addressed a number of times in the past and would require a very specific, and perhaps highly complicated, definition to avoid problems of interpretation.

Second, there is the problem of identifying the appropriate geographic area that a small business loan might provide economic benefit. For example, a company may have its headquarters office with only skeleton staff in one census tract within an SMSA but the majority of the company's payroll and work is located in another census tract or tracts or even in another community or SMSA. For HMDA purposes, the loan would probably be reported in the headquarters' census tract.

Since passage of the Community Reinvestment Act, the nature of mortgage-making has been revolutionized by the secondary market. This market purchases home loans originated by banks and thrifts, packages them into securities, and re-sells them to investors. While this benefits the liquidity of the mortgage market, freeing up additional funds for more home loan-making, it has increased pressure to red-line. That is, in packaging these loans, secondary market-makers insist the loans meet strict criteria. Mortgage insurers, for example, use census tracts as a basic screening device.

a) Is there any evidence that banks avoid making loans in certain low income areas because of the need to re-sell all loans to the secondary market?

b) Have you discussed this situation with secondary market players? Can you come to a regulatory solution?

No. In fact, the secondary market facilitates mortgage lending.

Freddie Mac has very carefully examined its underwriting guidelines to see if those guidelines may have contributed to the perception that lenders avoid making loans in certain areas because of the need to re-sell those loans into the secondary market. The very notion that the secondary market might inhibit lenders' ability to make loans in certain areas runs contrary to the very reason the secondary market was created: that is, to increase the availability of mortgage funds. Lenders can replenish their supply of lendable funds by selling all or some of their loans to secondary market conduits, like Freddie Mac. Since Freddie Mac is in the market everyday, its existence assures that there is a reliable source of funds for the lending industry.

Freddie Mac fulfills our congressional mandate by purchasing investment quality mortgages from lenders (both large and small), packaging these mortgages into securities, and selling these securities to investors. In this way, Freddie Mac facilitates the flow of mortgage funds from investors to borrowers.

However, Congress determined when it created Freddie Mac that the corporation purchase only investment quality loans. The Conference Report to its authorizing legislation emphasizes that as follows:

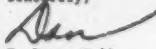
"[The bill] contains specific limitations on the kind and quality of mortgages eligible for purchase in order to protect against the accumulation of high-risk mortgages which could jeopardize the soundness of the Corporation. Also, in order to protect the Corporation from becoming a 'dumping ground' for mortgages rather than a truly secondary market facility, the bill requires that mortgages 'be of such type, and class as to meet generally the purchase standards imposed by private institutional mortgage investors'."

As a result, Congress wrote in provisions to Freddie Mac's charter which were intended to ensure these requirements were met. One of these charter restrictions is that Freddie Mac can only purchase mortgages with 80% loan-to-value ratios. There are three exceptions to this restriction: (1) if the seller retains a participation in the loan, (2) if the seller agrees to repurchase the loan upon default; or (3) if any balance greater than 80% LTV is insured by private mortgage insurance (PMI). It may be that the real reason underlying claims that lenders avoid making loans in low income areas is that lenders cannot obtain PMI, or are themselves unwilling to participate in or buy back a loan in the event of default.

With this in mind, it seems that the secondary market is more often the excuse than the reason a loan cannot be made in the first place. In fact, lenders are given broad discretion to make creditworthy loans and either sell these loans or keep them in portfolio.

Whatever the perception, some numbers may help tell the story. Recent evidence indicates that the secondary market does not contribute in any way to redlining. For example, with a 1987 loan limit of \$153,100, Freddie Mac's average loan purchased was only \$57,000. Also, 30% of Freddie Mac's purchases last year were loans of less than \$40,000, which is achievable by a borrower making less than \$16,000 a year. I trust this information satisfactorily answers your questions. Should you need additional information, please let us know.

Sincerely,

  
M. Denny Wall  
Chairman

Attachments

provement loans are distributed geographically by census tract in the area in which the organization operates.

Examiners also go out and visit with business leaders, governmental officials, community group representatives—a broad spectrum of the community—and ask them what they think the community's credit needs are, and also ask them whether they think this specific organization is doing a good job. And I think that's very much a performance factor.

And then the examiners will also, for example, look to see whether or not there is what I would call high level commitment. In other words, is the president or the CEO committed to this?

Senator GRAHAM. I don't want to get into semantics, but I would define most of what you just said as process. My definition of performance is stating what you want to ultimately happen. Has there been a closer relationship, for instance, between the percentage of the population in the community served and the allocation of financing within that community? We had some testimony yesterday about communities which were—these are arbitrary numbers but close to the testimony—80 percent Hispanic and yet only 5 percent of the loans of the financial institution in the community went to Hispanics. Those kinds of discrepancies, is there monitoring against performance that has numbers and quantifiable standards of measurement?

Ms. SEGER. Well, I'm sorry I didn't explain the HMDA well enough. That's the kind of thing that the HMDA data would be reviewed for.

Senator GRAHAM. And if a bank falls below the numerical standards of performance, then what happens?

Ms. SEGER. Well, we at the Fed don't have hard and fast lines on this distribution. It's not our job to allocate the credit geographically or any other way.

But we do look at how these mortgages are made and what the geographic distribution is and whether the areas that get a tiny share are in fact Hispanic or places where other minorities live or are very low income areas. We look at that, but then the next step is to see if there is a good explanation. It might be that there's less demand from these particular neighborhoods for home improvement loans or for home mortgages. But examiners do make an effort, as I said, they do look at the data and they do make an effort to figure out what's really going on and I would call that performance criteria, and it is something that is done.

Senator GRAHAM. Mr. Seidman.

Mr. SEIDMAN. I think our process is very much as Governor Seger has suggested. We haven't been able to put as much resources in this area as I think the Fed has been able to do recently, so some of the things we have yet to expand. We rely upon the banks more to go out and determine what the community needs are, and I think we definitely do not set standards that say if they're 80 percent of some group they ought to get 80 percent of the loans or even any percent, because each case needs to be studied on its own.

What we look for is whether the bank is trying to fulfill the legitimate needs of the particular area or group involved.

Senator GRAHAM. Mr. Clarke.

Mr. CLARKE. Senator Graham, the only thing I would add to what's been said is that I think people have overlooked the fact that there are 12 assessment factors that are incorporated into our regulations. It's my understanding that those assessment factors were adopted as a joint effort by the bank regulatory agencies and that they set out some very specific things that examiners are supposed to evaluate. For example, factor No. 2 is the extent of the bank's marketing of special credit-related programs to make community members aware of available credit services. While I would agree with you that that is part of the process, there are specific things that examiners are asked to do to determine what the bank has done in its marketing program that ultimately result in something tangible. The bank has either done some marketing in those areas of the community or it hasn't. That's going to be visible to the examiner during the course of the examination.

There was some comment made yesterday by some of those who appeared before the committee that there didn't appear to be any standards against which CRA performance is evaluated. I think people simply tend to forget about the existence of these assessment factors.

Senator GRAHAM. When I get back to the chairman's questions, we have some questions that relate to some of those specific comments made yesterday. We will return to this issue at that time.

Mr. WALL. Senator Graham, I would add a couple of thoughts to your question of is it process or performance that's being assessed.

It seems to me another way of posing it is, is it objective or subjective? And it is I think a human characteristic that one would choose to use objective criteria rather than subjective because you can come back and defend it. You can identify it much to the point that Comptroller Clarke has just been talking about where you can identify something that has been done or is indicated in the tabulation of the data that's available from the number of loans made and by neighborhood or by ZIP code or whatever the assessment might. So I think it is, yes, more objective than subjective.

Senator GRAHAM. Well, my time is up. I'm going to return to this question of process versus performance because I think it's a fundamental difference and I don't think it's objective versus subjective. I recently spent some time with the Boston Red Sox in spring training. It's not a question whether Roger Clemens pitches 50 innings in spring training; it's whether he gets anybody out that is going to count in terms of his success as a pitcher. And I think it's not whether you can count it or not; it's what is it that you are counting.

Mr. WALL. But you count the outs, too.

Senator GRAHAM. Yes. Senator Garn.

Senator GARN. Thank you, Senator Graham.

I apologize for not being here earlier. The schedule was bad when it started today and it's gotten worse as the day has gone on and I have a great temptation that I'm going to resist to ask Dan Wall a lot of tough questions. After 16 years I've never had him in this position before. Nevertheless, Dan, I'm going to be nice and resist that temptation and not do it.

I appreciate all of you being here and I have no questions at this time, Mr. Chairman.



The CHAIRMAN. Mr. Seidman, the Amalgamated Clothing and Textile Workers Union recently filed a protest with the Fed regarding community reinvestment progress by Continental Illinois. That's a bank your agency effectively owns. In 44 pages the union documents striking noncompliance. It asserts that while under FDIC control Continental has terminated major retail operations, terminated municipal bond purchases, targeted mortgage lending to predominantly white moderate and high income neighborhoods.

Given these allegations of noncompliance with CRA, how does FDIC justify acquiescence with Continental's latest foray?

Mr. SEIDMAN. I'm not familiar with that, Mr. Chairman, so I'll have to take a look at it. But basically, while we are substantial owners of Continental Illinois, we don't either run the bank nor are we its regulator. Therefore, we don't deal directly with problems like this with the bank. That would be dealt with by their management and their principal regulator. I guess that's why I'm not familiar with the matter at this point.

The CHAIRMAN. For the record, could you give us a response?

Mr. SEIDMAN. I'd be happy to look into it, yes, sir.

[The following information was subsequently submitted for the record:]

Request—Comments on Continental's "latest foray", given allegations of noncompliance with CRA as presented in a protest filed by the Amalgamated Clothing and Textile Workers Union.

The FDIC has been advised that the Amalgamated Clothing and Textile Workers Union (ACTWU) filed a protest with the Federal Reserve System in March, 1988. ACTWU is requesting that the application of Continental Illinois Bancorp, Inc. and Continental Illinois Corporation to acquire the Grand Canyon State Bank, Scottsdale, Arizona, be denied. The application is currently pending.

The Federal Reserve has jurisdiction in this matter. The FDIC is involved only to the extent that information on the Grand Canyon State Bank is requested and provided since this financial institution is a State non-member bank supervised by the FDIC. Information relative to Continental would be provided by the Office of the Comptroller of the Currency, as the regulator of national banks.

The FDIC's role with regard to activities of Continental is in accordance with the August, 1984, Assistance Agreement by and among Continental Illinois National Bank and Trust Company of Chicago, Continental Illinois Holding Corporation and the FDIC. The Assistance Agreement sets forth limitations on acquisitions and requires FDIC approval only in certain cases. In the instant case, it does not appear that the FDIC will be required to act.

The CHAIRMAN. Governor Seger, Professor Bradford said the Fed maintains arbitrary rules on accepting public comment. He says you can extend the comment period but in the last 2 years you've denied most such requests.

#### MORE TIME NEEDED TO PRESENT CASES TO FED

What is Fed policy? Don't you think that with increasingly complex interstate mergers involving several agencies and even different district offices within the same agency that community organizations need more time to collect information and present their findings to the Fed? Moreover, is there a better way to alert community groups to mergers and provide pertinent information already filed?

Ms. SEGER. We at the Fed are in the middle on this. The applicants want to get the word back on the merger applications as quickly as they can because usually there are specific times in-



volved in the offers to purchase. So they are putting the pressure on to get this thing through. We shoot to get a decision made in most cases within 60 days. Therefore, we have typically a 30-day period in which we will receive comments. By the way, the comments or the protests can come in from many groups above and beyond the community groups. It can be a competitor of one of the institutions, for example, who can send in a complaint or some unhappy stockholders. So the procedure is not set up specifically to deal with the CRA-type complaints.

But our view has been that that has been adequate in those cases where—

The CHAIRMAN. You say it's not set up to deal with the CRA-type complaint?

Ms. SEGER. With just those. The procedure is set up to deal with all complaints.

The CHAIRMAN. Do you intend to modify your procedures so it is qualified to handle that?

Ms. SEGER. Well, what I was going to say was that when there is a community group that can argue that the case is very complicated and it involves multiple banks and various states and various Federal Reserve districts, we have in fact extended it beyond the 30 days. But in most instances we feel that the 30 days has been adequate for them to comment to us.

The CHAIRMAN. One other point, and I know you've been here a long time testifying and we have other witnesses. But I got the impression from the people who testified yesterday that they were concerned that the Fed didn't seem to have a central policy that was effective; that in some areas the Fed has done very well. They commended several areas where the Fed seemed to be concerned about. In other areas, not.

Is there any way that you can bring your people together so that those who have been vigorous in enforcing CRA would help to bring the others along so that you can have a more uniform consistent policy of effective enforcement?

Ms. SEGER. Yes, sir, there certainly is, and we do hold meetings about once a year and bring in the community affairs officers of each of the twelve district banks to have a meeting, compare notes. We talk about the overall policy because there is an effort to keep everybody going in the same direction at the same rate of speed.

The CHAIRMAN. I notice you have here a table, attachment B, in which you point out the formal talks given by the Reserve System community affairs officers during 1987. Philadelphia was the star. Philadelphia had 18. Boston had only one. San Francisco, 3; Minneapolis, 2. You did better in Dallas and Chicago than some of the others—8 and 9 there.

But it seems to me from what we've heard, Philadelphia is a city that is way out in front on this. They've been very good. They found it pays. They found that by making loans in low income ethnic areas, provided the structure is sound and provided the credit rating of the borrower is good, has been very good business. We had two banks testifying yesterday saying it had worked out very well for them, much better than they thought it would.

It seems to me if we could get that Philadelphia story, if you will, across, that you might make some real progress elsewhere.

Somehow, I think bankers are—they do a great job by and large. They are very bright people and they have to pay attention to their profit and loss very carefully, but I think that they also tend to have some cultural lag here. I think if they understood the benefits of this, you would get some enthusiastic action here.

Ms. SEGER. Also, I would just add that those are the formal talks given. There are some other vehicles used such as holding seminars, hosting various forums, etc., and those are not picked up in that table. Again, we want to have all the Federal Reserve Banks conscious of this, but we haven't tried to dictate the exact approach to them down to the specific number of speeches to give. But I think that you'll notice on a couple of pages before the table you're alluding to that we go through for each of the banks and show some of the things that they've done in the last 2½ or 3 years. And I think you would be impressed by both the number and the variety of approaches that have been used. I'm not saying or not pretending that certainly we can't do it better.

The CHAIRMAN. Senator Graham.

Senator GRAHAM. Mr. Chairman, you've been asking some brilliant questions in your absence. [Laughter.]

I am also going to have to leave for a few minutes. I'd like to make a request for some followup information to pursue the questions that I was asking previously about process versus performance standards of measurement. For the record, I would like to request that each of you would submit what you consider to be your performance standards of regulatory evaluation.

No. 2, also for the record, I think Mr. Seidman commented about the issue of resources. I'd like to have each agency submit what has been the last 5 years of your allocation of regulatory staff resources to CRA enforcement. And I will say that there was some comment yesterday which indicated a sense that that had been declining.

[Response to request of Senator Graham follows:]

RESPONSE TO REQUEST OF SENATOR GRAHAM FROM  
L. WILLIAM SEIDMAN

Excerpts From Manual for Compliance Examinations

Performance standards of regulatory evaluation.

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Section

**COMMUNITY REINVESTMENT**

**INTRODUCTION**

The Community Reinvestment Act (CRA) (12 U.S.C. 2901 et seq.) is intended to encourage banks to help meet the credit needs of their entire communities, including low- and moderate-income neighborhoods, while preserving the flexibility necessary to operate in a safe and sound manner.

Encouragement is to be provided by the Corporation which is required to:

- Use its examination authority to encourage a bank to help meet the credit needs of its entire community, consistent with the safe and sound operation of the bank;
- Assess, in connection with its examination, the bank's record of helping to meet the credit needs of its entire community; and
- Take that record into account in evaluating an application for deposit insurance, a branch or other deposit facility, office relocation or merger.

Proponents of the CRA were concerned, among other things, with situations in which local lenders reportedly exported local deposits to other areas despite sound local lending opportunities. Such disinvestment was considered a threat to community and neighborhood vitality. Lenders, therefore, are encouraged to give particular attention to local housing and development needs of urban and rural areas. Increased lender sensitivity to such needs would help preserve, rehabilitate and revitalize such areas. Moreover, even though credit for local housing and community development was emphasized, it was realized that other types of credit provide community facilities and services necessary for neighborhood vitality and, more generally, a healthy local community.

The CRA is not intended to inject hard and fast rules or ratios into the examination or application process. Rather, the law contemplates a judgmental evaluation of a lender's record in order to accommodate varying circumstances. Nor does the CRA require banks to make high risk loans that jeopardize their safety. Rebuilding and revitalizing communities are viewed as beneficial for both communities and banks.

**PART 345 — COMMUNITY REINVESTMENT**

The Corporation's implementing regulation (Part 345) requires the board of directors of each insured nonmember bank to adopt and, at least annually, review a CRA statement. The statement must include: (1) a delineation on a map of each local community served by the bank, (2) a list of the specific types of credit the bank is prepared to

extend within each local community, and (3) a copy of the CRA notice. The regulation also encourages each bank to include in its statement a description of its efforts to ascertain and help meet community credit needs.

A bank must provide in each office a CRA notice, the exact wording of which is prescribed in the regulation. The public notice indicates that the CRA statement is available, that written comments on the statement and the bank's community lending performance may be submitted to the bank or the Corporation, that a file of such comments is publicly available, and that the public may request announcements of applications covered by the CRA from the Corporation.

Each bank must keep a public file of CRA statements in effect and CRA-related public comments received during the past two years.

The CRA regulation sets forth a list of factors which the Corporation will consider in assessing each bank's record of helping to meet community credit needs, including those of low- and moderate-income neighborhoods. Banks are not required to adopt particular activities on the list since the regulation is designed to allow each bank considerable flexibility in determining how it can best help to meet the credit needs of its entire community in view of its particular skills and resources.

The Corporation's assessment of a bank's CRA record will be taken into account by the Corporation in evaluating a variety of applications.

In essence, the regulation encourages banks to become aware of the full range of credit needs of their communities and to offer the types of credit and credit-related services that will help meet those needs. However, the regulation does not require banks to offer particular types or amounts of credit.

**BACKGROUND FOR EXAMINATIONS**

**Judgmental Process**

In conducting a CRA examination, the examiner is expected to adjust the CRA procedures on a case-by-case basis to accommodate banks that vary in size, expertise and locale. Community credit needs will often differ with the specific characteristics of each local community, and a bank should be evaluated on the basis of its attempts to ascertain, its determination to help meet, and its performance in helping to meet community credit needs in the context of its resources and local circumstances.

**Balanced Viewpoint**

The examiner should maintain a balanced perspective in conducting a CRA examination. The

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examiner cannot normally conclude on the basis of any one factor that a bank is or is not helping to meet the credit needs of its local community or communities. Nor can the examiner adequately assess a bank's performance on the basis of any one source of information, data or opinion. For that reason, the examination procedures are designed to ensure that information from both the bank and the community is objectively reviewed and evaluated.

### Bank's Input

The examination procedures give each bank the opportunity to demonstrate that it is having a beneficial influence on its local community or communities. Bankers that are helping to meet community credit needs are proud of that fact and will be of substantial assistance to the examiner in assessing the performance of their banks.

### Examiner Encouragement

When appropriate, an examiner should encourage a bank to improve its CRA record by discussing with management various ways in which the bank may strengthen its performance. The examiner should not, however, insist on any specific action by the bank, such as the making of a certain type of loan, which would interfere with the bank's responsibility for establishing its own policies.

### Examination Burden

The examiner must be careful to not unduly burden the bank since Congress did not intend to impose significant new reporting or recordkeeping requirements on banks. The examiner should normally request only required records and other existing information, but the scope of the review must always be sufficient for an adequate assessment.

### Bank's Financial Condition and Size, Legal Impediments and Local Economic Conditions

A bank's ability to help meet community credit needs is influenced by its financial condition and size, as well as by any legal impediments and the local economic conditions under which it operates. An examiner must take these considerations into account in assessing the bank's performance and in providing encouragement.

### Technical Compliance with the Regulation

The examiner will check for compliance with the specific requirements of the regulation. However, compliance with procedural requirements does not imply that the bank has been serving local credit needs. The converse is also true: noncompliance with a technical requirement does not necessarily mean that the bank is not helping to meet community credit needs. The examiner must

not lose sight of the intent of the statute in checking for technical compliance with the regulation. The entire examination is designed primarily to determine the extent to which the bank has helped and is helping to meet community credit needs.

### Communication, Community Development and Low- and Moderate-Income Neighborhoods

In assessing the record, the examiner should bear in mind the special emphasis placed on effective communication and community development activities. With respect to communication, the premise is that community needs which can be met on a safe and sound basis are more likely to be met when the community is aware of the types of credit available and the lender is well informed about community credit needs. Hence, efforts to ascertain community credit needs and to publicize available credit services, including measures to identify the credit needs of, and to advertise in, low- and moderate-income neighborhoods, are encouraged. The examiner is authorized to conduct interviews with community members when such action would be appropriate in determining community awareness of the bank's credit services and local perception of credit needs.

The CRA also focuses on activities that foster development within the entire community, including low- and moderate-income neighborhoods. Consequently, housing-related extensions, participation in community development programs, and small business financing, including loans to small farms, are viewed favorably.

## SELECTED FEATURES OF CRA EXAMINATIONS

### The CRA Statement

A bank must prepare a separate CRA statement for each local community it serves, including a delineation of the relevant local community. It does not necessarily follow, however, that the statement prepared for each local community must contain a unique list of available credits. A bank serving several local communities may elect to prepare statements that contain lists of credits which are similar or identical for the local communities served. Since some credit needs are common to many local communities, such an approach would be consistent with the intent of CRA. There are other ways for a multi-community bank to satisfy this requirement. The examiner need not be especially concerned with the specific method employed by a multi-community bank so long as it makes a good faith effort to inform members of each local community about their community's boundaries and the types of credit extended there.

### Reasonableness of Community Delineation

Each bank must delineate the local community or communities that it serves. For instance, a state-wide branching bank would serve a number of "local communities," the total of which would constitute its "entire community." Further, more than one office of a bank may serve the same local community. For example, a bank may have offices throughout a city and its suburbs and consider that entire metropolitan area to be the local community for those offices. Each community delineation must, of course, include the contiguous areas surrounding each office or group of offices.

Because many factors influence the size and shape of a bank's community, the regulation provides guidelines to assist each bank in defining its local community or communities.

The first guideline suggests the use of widely recognized existing boundaries such as those of SMSAs or counties for delineating a bank's local community or communities. Such boundaries frequently constitute a reasonable approximation of a bank's local community.

In general, a local community based on existing boundaries should be no larger than an entire SMSA or a county in a non-SMSA area. If a bank has offices in more than one such area, it will have more than one local community. When a bank has an office near the boundary of an SMSA or county, it should include those portions of adjacent counties that it serves. In rural areas, a local community may sometimes encompass more than one county but, generally, banks should not use states or regions of states to delineate local communities. A small bank that serves an area smaller than an SMSA or county may define its community to be a part of the SMSA or county. A bank may make adjustments in a community delineation in the case of areas divided by state borders, significant geographic barriers, or areas that are extremely large or of unusual configuration.

The second guideline proposes the use of effective lending territory, a concept more familiar to savings and loan associations than to commercial and mutual savings banks. The effective lending territory is that local area or areas around each office or group of offices where an institution makes a substantial portion of its loans and all other areas equally distant. If a bank employs its effective lending territory, it is encouraged to follow existing boundaries where practical.

One should not conclude from this guideline that each office necessarily serves a separate and distinct local community because each office typically has a different, though possibly partially overlapping, effective lending territory. If a bank is

represented throughout a trade or market area, it may be more reasonable to use that area as its local community.

Finally, the regulation allows a bank to use any other reasonably delineated area. A bank is thus given substantial leeway in specifying its local community so long as the definition is reasonable; that is to say, the bank can provide a sensible rationale for the delineation and has not arbitrarily excluded any low- and moderate-income neighborhoods.

### Low- and Moderate-Income Neighborhoods

In determining whether the community definition is reasonable, the examiner must be alert to situations where low- and moderate-income neighborhoods are gerrymandered out of a delineated area. Moreover, in assessing the record of a bank, the examiner should focus particular attention on its performance in low- and moderate-income neighborhoods within a local community.

Low- and moderate-income neighborhoods may be identified in most cases in a manner similar to the approach taken by HUD in administering the Community Development Block Grant Program. For this purpose, such neighborhoods are approximated by those census tracts in an SMSA where median family income is less than 80 per cent of median family income for the entire SMSA. Unfortunately, these data are not available for non-SMSA counties.

Non-SMSA areas, especially rural areas, present a particular problem in identifying low- and moderate-income neighborhoods. In those areas, the examiner may have to rely on personal knowledge of the area, physical inspection as necessary, discussion with bank personnel or a combination of these.

### Small Business Lending

Small business loans represent one type of credit which the Corporation believes is directly related to the purposes of the CRA. In considering small business lending, the examiner should not be concerned with any hard and fast or precise definition of what constitutes a small business. Instead, the examiner should regard as small business lending any loans to local firms whose access to credit is limited to local sources because of their size.



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### EXAMINATION OBJECTIVES

1. To determine if the bank's policies address the intent of the CRA.
2. To encourage sensitivity and responsiveness to community credit needs.
3. To determine that the bank is complying with the requirements of the CRA regulation.
4. To determine the reasonableness of the bank's community delineation(s).
5. To assess the bank's record in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with a safe and sound operation.
6. To develop, organize and report information on the bank's record for use in the supervisory and application processes.

**EXAMINATION PROCEDURES**
**Limited Review**

1. Determine the method used by the bank to delineate its local community or communities and the reasonableness of each such delineation. (345.3(a))
2. Assess the bank's record of performance in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with its safe and sound operation. The various assessment factors detailed in the regulation should all be considered to the extent applicable to the particular bank and the community or communities in which it operates.

In assessing the record, the examiner should review the Officer's Questionnaire, review and analyze the bank's public file and interview responsible personnel to determine efforts undertaken by the bank to ascertain and help meet community credit needs. To the extent necessary for an adequate assessment, the examiner is encouraged to interview community members to determine community awareness of the bank's credit services and local perception of credit needs as well as the bank's efforts to meet those needs.

3. Review each CRA statement in effect during the past two years to determine that all required items are included. (345.4(b)) Note the specific types of credit the bank is prepared to extend within the local community and deter-

mine whether the types of credit in the CRA statement correspond with the types of credit actually being extended. Request an explanation of any difference. (345.4(b)(2))

4. Review minutes of directors' meetings to verify that all required CRA statements have been adopted, are reviewed at least annually and that the board has acted upon any interim changes and noted such actions in the minutes. (345.4(d))
5. Ascertain that the public file contains all signed comments received from the public that specifically relate to any CRA statement or to the bank's performance under the CRA as well as any responses made by the bank. The file should also contain all CRA statements in effect during the past two years. (345.5)
6. Ascertain that the bank's public notice contains the correct language and is properly posted. (345.6)
7. Review with management the following:
  - The extent to which the bank is helping to meet the credit needs of its community;
  - Suggestions that might better enable the bank to help meet the credit needs of its community;
  - Deficiencies or exceptions in policies or practices; and
  - Procedural violations of the regulation.

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#### Expanded Review

1. Ascertain from bank personnel what steps the bank has taken or plans to take which indicate whether it is helping to serve the credit needs of its local community or communities.
2. Obtain the following:
  - Minutes of the board of directors' meetings, particularly those dealing with the adoption, review and revision of all CRA statements.
  - The bank's files of public comments and recent CRA statements.
  - Comment letters received by the Corporation.
  - The bank's loan and investment policy and procedural manuals, along with other manuals relating to the CRA.
3. Review minutes of director's meetings and verify that the board has:
  - Adopted a CRA statement for each delineated community.
  - Reviewed each statement at least annually.
  - Acted upon any material change in each statement at the first regular meeting of the board following the change.
4. Review and analyze the public files for:
  - Any signed, written comments received from the public during the past two years that specifically relate to any CRA statement or to the bank's performance in helping to meet the credit needs of its community or communities. Determine that the comments do not contain any material specifically prohibited by the regulation. However, the comments themselves should be considered.
  - Any responses to the commentors that the bank may have made.
  - All CRA statements in effect during the past two years.

Note: Inherent in the process of reviewing public files is the option of contacting commentors and/or community members to the extent deemed necessary.
5. Review each CRA statement in effect during the past two years and:
  - Ascertain if the bank's delineation of its local community or communities is reasonable. Give special attention to the following:
    - Considerations used by the bank to define its community.

—Community boundaries that are sharply asymmetrical, too narrowly drawn or so broad that the bank fails to focus on its local community.

—Whether any low- and moderate-income neighborhoods have been arbitrarily excluded.

—Public comments specifically relating to the reasonableness of the bank's delineation(s).

—Any relevant information obtained from other examination programs that have been performed.

If a question remains regarding the reasonableness of the community delineation, a review of community boundaries drawn by comparable local banks may provide useful information.

- Review and analyze the specific types of credits within certain categories that the bank is prepared to extend within the local community. Determine if the types of credit in the CRA statement correspond to the types of credit actually being extended by the bank. Request an explanation of any differences. If feasible and appropriate, review the list of available credits prepared by comparable local banks.
- Determine that a copy of the CRA public notice is included.
- Analyze any of the following optional information that the bank may have included:
  - A description of how its efforts, including special credit-related programs, help to meet community credit needs.
  - A periodic report regarding its record of helping to meet community credit needs.
  - A description of its efforts to ascertain the credit needs of its community, including efforts to communicate with members of its community regarding credit services.
  - Any other material the bank may have included.
- 6. Analyze the bank's policies, procedures and operating practices to determine if the bank:
  - Provides the CRA public notice in a manner specified by the regulation. (A bank may reprint this notice as a poster or flyer to be placed in its lobby. The notice requirement may also be satisfied by making the CRA statement, which includes the notice, available as a brochure in the lobby.)

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- Makes all CRA statements available to the public as provided by the regulation.
  - Makes the public comment files readily available for public inspection as provided in the regulation.
7. Review the bank's credit underwriting and appraisal criteria and the terms and conditions of loans to determine if they are being used for exclusionary purposes contrary to the objectives of the CRA.

### 8. Assessment Factors

- Activities conducted by the bank to ascertain the credit needs of its community, including the extent of the bank's efforts to communicate with members of its community regarding the credit services being provided by the bank.

Ascertain from bank records and through interviews the extent to which the bank has communicated with members of its local community or otherwise has attempted to determine such needs. Pertinent factors may include:

- Management review of written, signed comments received in response to the bank's CRA statement(s).
- Studies conducted or reviewed by the bank concerning local credit needs.
- The extent of the bank's efforts to communicate with members of its community regarding the credit services it is providing. Such members might include customers of the bank; the PTA; merchants' associations; religious organizations; local government officials; block clubs; neighborhood organizations; coalitions of neighborhood organizations; local civil rights, consumer, minority, and non-English speaking groups; housing counseling service centers; community development corporations; nonprofit housing development corporations; and local development corporations.
- The bank's communications with private organizations as may be identified by the Office of the Assistant Secretary for Neighborhoods, Voluntary Associations and Consumer Protection at HUD.
- The bank's review of the local government's Community Development Plan and Housing Assistance Plan prepared in conjunction with HUD's Community Development Block Grant Program.
- Economic forecasting, as developed or used by the bank.

- The extent of the bank's marketing and special credit-related programs to make members of the community aware of the credit services offered by the bank.

Review the bank's marketing program and determine if it is adequately designed to encourage applications for loans in its community, particularly in low- and moderate-income neighborhoods. Pertinent factors may include:

- Any working relationships the bank may have with real estate brokers or others who service low- and moderate-income neighborhoods.
- Mortgage counseling programs and programs of management assistance for small or minority businesses.
- Development and participation in mortgage review boards.
- Credit and credit-related services in low- and moderate-income neighborhoods compared to such services in other neighborhoods served by the bank.
- Use of bank representatives for seeking out potential housing-related and small business demand in low- and moderate-income neighborhoods.
- Advertising the types of loans the bank is willing to make in media likely to reach low- and moderate-income individuals in the bank's local community or communities.
- Availability of convenient hours in offices accessible to residents of low- and moderate-income neighborhoods.
- Use of informational brochures and participation in other educational efforts.

- The extent of participation by the bank's board of directors in formulating the bank's policies and reviewing its performance with respect to the purpose of the CRA.
- Any practices intended to discourage applications for types of credit set forth in the bank's CRA statement(s).

Review other fair lending examination programs, particularly as they pertain to interviewing and prescreening. Additionally, ascertain the following:

- Whether administrative loan personnel and loan officers are aware of the CRA and the requirements of the implementing regulation.
- Whether lending officers are aware of the bank's delineation of its local community

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or communities and its policies, if any, with respect to its commitment to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods.

- Whether loan officers are aware of the types of credit the bank offers to members of its local community or communities.
- Whether public contact personnel are aware of the availability of the bank's CRA statement(s) and files of public comments.
- Whether the bank is prepared to extend certain types of credit in some local communities or neighborhoods but not in others. An explanation of any difference should be requested.
- The extent to which the bank is willing to make loans in its delineated local community or communities, utilizing information derived below. Special attention should be given to the specific reasons why loan applications have been denied, whether or not such denial has been on a prohibited basis.
- Whether loan officers or other public contact personnel prescreen potential applicants from obtaining loans that the bank has stated it is willing to make, particularly applicants from low- and moderate-income neighborhoods.
- The geographic distribution of the bank's credit extensions, credit applications and credit denials.

Determine whether there is any indication of a geographic distribution of credit extensions, applications for credit and credit denials which would signify failure to serve selected areas of local communities, particularly low- and moderate-income neighborhoods. Initial reliance may be placed on discussion with other examiners, review of reports of examination and work papers from other examination programs performed. For those banks located in SMSAs, additional reliance may be placed on other fair lending examination programs for ascertaining the volume and location of housing-related credits.

For loans made outside SMSAs, particularly with respect to banks that are not located in such areas, interview management and review internal files to determine the extent of housing-related lending in low- and moderate-income neighborhoods

and the extent to which the bank has not extended such credit in those areas.

Reliance may be placed upon geocoding of credit extensions, credit applications and credit denials. Where the bank is required to maintain logs of applications, the examiner will review the logs to determine the geographic distribution of loans, applications and denials. In conjunction with other fair lending examination programs, it may be necessary to analyze further the geographic distribution of small business loans, including loans to small farms within the bank's local community.

- Evidence of prohibited discriminatory or other illegal credit practices.

Review prior Compliance Reports and, in conjunction with other examination programs, determine the extent to which the bank is currently complying with the law.

- The bank's record of opening and closing offices and providing services at offices.

Information can be obtained from the correspondence or other Corporation files or from the bank's records. Ascertain the impact of such activities through the interviewing process and review of public comments with particular focus on low- and moderate-income neighborhoods.

- The bank's participation, including investments, in local community development and redevelopment projects or programs.

Review written lending policy and procedural manuals and interview lending officers to ascertain whether current programs include, or if the bank has considered involvement in, programs for satisfying potential credit needs such as the following:

- HUD's Community Development Block Grant Program.
- Local neighborhood preservation efforts.
- Community Development Corporations.
- Financing for Local Development Corporations.
- Neighborhood Housing Services.
- Investments in, or coordination with, Minority Enterprise Small Business Investment Corporations (MESBICs), or Small Business Investment Corporations (SBICs) in providing loans to business for which equity or subordinated debt is provided by MESBIC or SBIC.
- Purchase of securities of state and local housing agencies.



- The bank's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans, and small business or small farm loans within its community, or the purchase of such loans originated in its community.

Review the bank's financial statements, other appropriate records including HMDA statements, its written lending policy and procedural manuals, and interview lending personnel to ascertain whether the bank has originated or purchased such loans or has plans to do so.

- The bank's participation in governmentally-insured, guaranteed, or subsidized loan program for housing, small business or small farms.

This information may be obtained in ways similar to the ones in the assessment factor above. Examples of such government loan programs include:

- FHA/VA/FmHA mortgage loans to members of its community or communities.
- FHA Title I home improvement loans.
- SBA loan guaranty programs.
- Similar programs conducted by state or local agencies.

- The bank's ability to meet various community credit needs based on its financial condition and size, legal impediments, local economic conditions and other factors.

The financial condition of the bank may be ascertained from discussion with other examiners or review of examination work papers and reports.

Small banks may not have the specialized staff or financial resources needed to participate in some loan programs.

Legal restrictions on permissible activities, interest rates, and branches may affect a bank's ability to help meet community credit needs.

Adverse economic conditions caused by local or general economic difficulties may force a bank to temporarily curtail its lending activities.

Other factors may affect a bank's ability to help meet community credit needs.

- Other factors that in the Corporation's judgment reasonably bear on the extent to which the bank is helping to meet the credit needs of its entire community.

Pertinent factors may include:

- Purchases of state and municipal bonds, secondary mortgage market securities, or such other activities when they further special purposes in the community, such as the construction or rehabilitation of low- and moderate-income housing or other neighborhood or community development, or are issued by municipalities or other local public financing units which do not have access to the capital markets.

- Whether the bank's policies promote efforts to assist existing residents in neighborhoods undergoing a process of reinvestment and change.

- Any other relevant factors.

In some instances, it may prove beneficial or necessary to the assessment process to contact persons or organizations outside the bank to help determine the bank's record of meeting community credit needs and to identify unmet credit needs. The following are examples of types of outside contacts the examiner should normally make:

- Any person or organization that has specifically requested to speak to an examiner on a CRA or fair housing lending matter;
- Any person or organization that has raised in a CRA comment letter a substantial issue which requires further explanation or verification;
- A sample of persons or organizations with whom the bank has said it communicated. (This form of contact, however, should usually be made only in circumstances where the examiner determines a need to independently verify the bank's efforts to ascertain local credit needs.)
- Where there are indications of prescreening on the basis of race or sex or other disparate treatment of minorities or women, any person or organization that is likely to receive complaints or other information concerning such treatment.
- Any other person or organization likely to provide valuable information concerning the credit needs of the bank's community, its efforts to ascertain those needs and make known its credit services, or its efforts to meet the credit needs of the community. Examples include local community development officials, real estate brokers, city and county officials, chambers of commerce, community action groups, local business persons and clergymen.

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Initial contact may be made by telephone and suffice as adequate in some instances. An in-person interview should be conducted, however, whenever considerable information is likely to be provided, a number of people may be interviewed at the same location or relevant documentation may be made available for review. Outside contacts should be documented either in the workpapers or in the supervisory section of the Compliance Report, including the names and titles of the persons and/or organizations contacted and a brief summary of their comments regarding the bank's record of performance in the community.

9. Determine if the bank's record of performance demonstrates a recognition of its continuing and affirmative obligation to help meet the

credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation.

10. Review the following with management:

- The extent to which the bank is helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation.
- Suggestions that might better enable the bank to help meet the credit needs of its entire community.
- Procedural violations of the regulation.
- Deficiencies or exceptions in policies or practices.

# UNIFORM INTERAGENCY COMMUNITY REINVESTMENT ACT (CRA) ASSESSMENT RATING SYSTEM

## Introduction

The purpose of the rating system is to provide a uniform means for regulatory agencies to identify quickly those institutions which require varying degrees of encouragement in helping to meet community credit needs. This provides a comprehensive and uniform system for evaluating the performance of federally regulated financial institutions examined under the various assessment factors of the Community Reinvestment Act and facilitates more uniform and objective CRA ratings.

The rating system ranks financial institutions on a scale from 1 through 5 with a "5" representing the lowest level of performance under the Act and, therefore, the highest degree of concern. Level "3" reflects performance which is less than satisfactory.

This system further employs five "performance categories" or components from which the overall composite CRA rating is derived. The performance categories represent a grouping of the various assessment factors contained in the implementing regulation for the Act. Each performance category is evaluated on a scale of 1 to 5 with a "5" representing the lowest level and therefore the worst performance. As explained later, each performance category includes a narrative description for each rating level.

## Overview

Each financial institution is assigned a composite CRA rating that is based upon the institution's performance in meeting various community credit needs. An examiner begins to evaluate the institution's record in meeting community credit needs by first reviewing its financial condition and size, legal impediments, and local economic conditions, including the competitive environment in which it operates. The type of community in which the institution is located will also have a significant bearing on how the institution fulfills its obligations to the community. Community credit needs will often differ with the specific characteristics of each local community, resulting in a variety of ways an institution may meet those needs. To maintain a balanced perspective examiners must carefully consider information provided by both the institution and the community.

## Composite Rating System

The performance categories are individually assigned a numeric rating. In assigning the overall

composite CRA rating, the performance categories will be weighed and evaluated according to how well the institution meets the descriptive characteristics listed below.

**Rating (1)** – The institutions in this group have a strong record of meeting community credit needs. Both the board of directors and management take an active part in the process and demonstrate an affirmative commitment to the community. Institutions receiving this rating normally rank high in all performance categories. Such institutions have a commendable record and need no further encouragement.

**Rating (2)** – Institutions in this group have a satisfactory record of helping to meet community credit needs. Institutions receiving this rating normally are ranked in the satisfactory levels of the performance categories. Institutions in this category may require some encouragement to help meet community credit needs.

**Rating (3)** – Institutions in this group have a less than satisfactory record of helping to meet community credit needs. The board of directors and management have not placed strong emphasis on the credit needs of the community. Institutions receiving this rating have mixed rankings surrounding the midrange levels of the performance categories. Such institutions require encouragement to help meet the community credit needs.

**Rating (4)** – Institutions in this group have an unsatisfactory record of helping to meet community credit needs. The board of directors and management give inadequate consideration to the credit needs of the institution's community. Institutions receiving this rating generally rank below satisfactory in the majority of the performance categories. Such institutions require strong encouragement to help meet community credit needs.

**Rating (5)** – Institutions in this group have a substantially inadequate record of helping to meet community credit needs. The board of directors and management appear to give little consideration to the credit needs of the institution's community. Institutions receiving this rating generally rank in the lowest levels of the performance categories. Such institutions require the strongest encouragement to be responsive to community credit needs.

## Performance Categories

For purposes of evaluating an institution's CRA performance the various assessment factors and

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criteria are grouped into the following "performance categories":

**I. Community Credit Needs and Marketing**

The institution is evaluated in this category on its activities in determining the credit needs of its community and in marketing its services. Included in this category are assessment factors (a), (b) and (c) in addition to how well the institution delineated its community and other technical compliance regarding the posted notice and maintenance of public files.

**II. Types of Credit Offered and Extended**

The institution is evaluated in this category on the types and amounts of credit extended to the community and the degree to which those extensions are, in fact, helping to meet the community's needs. Included in this category are assessment factors (i) and (j) plus the institution's CRA statement.

**III. Geographic Distribution**

The geographic distribution of the institution's loans and any practices meant to discourage applications are considered in this category, as well as the impact of the opening or closing of any offices and the services offered at those facilities. Included in the category are assessment factors (d), (e) and (g).

**IV. Discrimination or Other Illegal Credit Practices**

The institution's compliance with anti-discrimination and other credit laws is evaluated in this category. The category includes assessment factor (f). The rating to be assigned here corresponds to the institution's composite compliance rating.

**V. Community Development and Other Factors**

The institution is evaluated in this category on its participation in community development and/or other factors relating to meeting local credit needs. Included in this category are assessment factors (h), (k) and (l).

Each of the performance categories and the level of performance relating to each category are described in greater detail below.

**Performance Category Rating System**

**I. Community Credit Needs and Marketing**

(Assessment Factors (a), (b), (c) and Community Delineation)

**Rating Level 1** - The institution has actively undertaken steps to determine community credit needs. These activities may include:

- Identifying the demographic makeup (racial/ethnic groups and low- and mod-

erate-income areas) of its community and making meaningful contacts with a reasonably full range of organizations (civil, religious, neighborhood, minority, etc.) to assist in determining the credit needs of all segments of its community;

- Taking into consideration comments to the public file which describe existing unmet credit needs; and
- Contacting local government officials to identify any needs of private lender participation in existing or prospective community development or redevelopment programs. (In rural areas the local government body may be the county supervisor's office or other appropriate office.)

The institution has actively undertaken marketing and credit related programs appropriate to the size and capacity of the institution and the nature and location of the community. These programs should reach all segments of its community. Community segments should include low- and moderate-income residents, small businesses and, where applicable, owners of small farms. Management has also established working relationships with real estate brokers and others who serve low- and moderate-income areas and who may provide assistance for small or minority businesses. There is evidence that senior management is aware of community concerns and activities.

**Rating Level 2** - The institution has undertaken activities to determine its community's credit needs. As a result of these activities, the institution is generally aware of the credit needs within its community, including low- and moderate-income areas. The institution has initiated a dialogue with community representatives such as local government, neighborhood, religious, and minority organizations, or small business and small farm organizations. The institution has undertaken marketing and credit related programs but the programs are not ongoing or comprehensive. Senior management demonstrates an awareness of community concerns and activities.

**Rating Level 3** - The institution's activities to determine community credit needs are limited. The institution's employees may serve as volunteers on community organization boards and committees. However, the institution has not established a systematic method to determine how or if its employees' volunteerism assists the institution in meeting its CRA goals. The institution's advertising may be principally deposit oriented. In addition, the

institution generally has made no efforts to market its services on an equal basis to all segments of its community. Marketing and credit related programs do not include a mechanism for reaching low- and moderate-income areas within the delineated community. The institution's marketing effort does not adequately focus on marketing the types of credit for which the institution has identified a need (or a need is otherwise apparent). There may also be some concern about the community delineation.

**Rating Level 4** -- The institution's efforts to determine community credit needs are very limited and fail to address major segments of its community. Management has not established a dialogue with organizations representative of the community, including any which represent low- and moderate-income or minority neighborhoods within the delineated community. The institution's marketing and credit related programs are limited or poorly conceived. There may also be some concern about the community delineation. Senior management is unaware of special needs of low- and moderate-income residents, small business and small farms.

**Rating Level 5** -- The institution has not undertaken any meaningful efforts to determine community credit needs. Management has limited knowledge regarding the community's demographic characteristics. The institution's marketing and credit related programs are either non-existent or have repeatedly excluded low- and moderate-income areas within the delineated community. There may also be some concern about the community delineation.

## II. Types of Credit Offered and Extended (Assessment Factors (i), and (j) and CRA Statement)

**Rating Level 1** -- The institution has investigated the need for different types of credit within its community such as residential mortgage loans, housing rehabilitation and home improvement loan, and small business or farm loans, including the need for private, as well as, government-insured, guaranteed, or subsidized forms of such loans. It has then made an explicit effort to assure that its loan policies are responsive to the needs and has examined the extent to which it and other institutions within the community are meeting the need for such loans. The institution's CRA statement lists the types of loans found to be needed in the community. The involvement by the institution in the making of each type of loan

listed in the statement demonstrates an affirmative effort to make such loans and to do its share in meeting existing needs, consistent with its resources and capabilities.

**Rating Level 2** -- The institution's CRA statement and loan portfolio indicate that it has investigated the need for residential mortgage loans, housing improvement/rehabilitation loans, small business and farm loans, and private, as well as government-insured, guaranteed, or subsidized forms of such loans within its community. It has made an explicit effort to assure that its loan policies are responsive to the needs found. The institution's performance in this category is distinguished from a 1-rated institution primarily in the extent to which it is marketing the availability of loans and/or in the degree to which the types and volume of loans being made match the community's most pressing credit needs.

**Rating Level 3** -- The institution may not be offering one or more types of credit listed in its CRA statement, despite a capacity to do so. The institution's loan portfolio and other sources, including peer analysis, may indicate that the institution's share of loans of a type or types identified as needed in the community, including any low- and moderate-income areas, is marginal or somewhat below average, particularly with respect to extensions for residential housing, small business or farm credit.

**Rating Level 4** -- The institution's record of offering and of making loans reveals that it is doing relatively little to help meet known or demonstrated credit needs for residential, small business or small farm credit, particularly for residents of low- and moderate-income areas. Its participation in private, as well as government insured, guaranteed or subsidy loan programs is either prefatory or nonexistent, under circumstances where the need for such loans has been identified and the lender can articulate no objective supportable reason for its low level of participation.

**Rating Level 5** -- The institution is unwilling to adapt its credit offerings to serve demonstrated unmet credit needs in its community, particularly for housing, small business or small farm credit. This rating would be particularly appropriate where the lender's failure to meet these needs was cited in a previous examination.



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## Appendix

## III. Geographic Distribution (Assessment Factors (d), (e) and (g))

**Rating Level 1** -- The geographic distribution of the institution's credit extensions, applications and denials indicate that the institution is making the substantial portion of its credit available to all areas within its community. The institution has reviewed the geographic distribution of its credit extensions, applications and denials in a manner appropriate to the size and capacity of the institution and the nature and location of the community. Where that review has disclosed a very low level of applications from or loans to a particular neighborhood or area, especially low- or moderate-income areas, the institution has reviewed its marketing practices to determine what, if any, impact they may have had on the distribution. Where appropriate, the institution has either revised its marketing practices or lending policies or both. The institution's offices are reasonably accessible to all segments of its community and banking hours are tailored to meet the convenience and the needs of its customers. Finally, the institution considers, in advance, the potential impact of opening and closing offices on its ability to continue offering reasonably equal services throughout its community.

**Rating Level 2** -- The geographic distribution of the institution's credit extensions, applications and denials indicate that the lender is making credit available to all areas within its community. The institution has taken steps to eliminate unreasonable lending patterns disclosed by examiners or which have resulted from the review of the institution's policies or practices. The geographic distribution of applications reveals no pattern suggestive of any practice of discouraging or "prescreening" applications. The institution's record of opening and closing offices and the provision of services at its offices do not reflect any disparate treatment of minority or low- and moderate-income neighborhoods. Offices are reasonably accessible to all segments of its delineated community. Services and banking hours are periodically reviewed to assure accommodation of all segments of the delineated community.

**Rating Level 3** -- The geographic distribution of the institution's credit extensions, applications and denials may suggest unreasonable lending patterns. Management has not attempted to review its lending policies and procedures or to analyze the institution's lending patterns within its community. The institu-

tion's record of opening and closing offices and its provision for services at its office may indicate a disparity of treatment between certain areas within its community. Such a disparity is isolated and not an overall intentional pattern or practice. Management has plans to undertake immediate steps to restore reasonably equal service to any affected areas.

**Rating Level 4** -- The geographic distribution of credit extensions, applications and denials reveal unreasonable lending patterns, particularly in low- and moderate-income neighborhoods or areas of racial/ethnic concentration. The geographic distribution of applications may indicate a possible pattern or practice of discouraging or illegally prescreening applications. The institution's record of opening and closing offices and the provisions of services at its offices may suggest a pattern of disparate treatment of minority or low- and moderate-income neighborhoods. The record might portray an institution that has systematically sought to close or curtail services at offices serving minority or less affluent neighborhoods while opening new offices in developing, majority or upper-income areas.

**Rating Level 5** -- The geographic distribution of credit extensions, applications and denials reveals extensive systematic unreasonable lending patterns. The institution has adopted loan policies and procedures, such as unjustifiably high minimum mortgage amounts or down payments or restrictions based on the age of property, which have or can reasonably be expected to have a significantly adverse impact on loan availability in low- and moderate-income or minority neighborhoods. The institution's record of opening and closing offices and the provision of services at its offices suggest a continuing pattern of disparate treatment of minority or low- and moderate-income neighborhoods. Where this was previously cited, management has not taken any corrective action.

## IV. Discrimination or Other Illegal Credit Practices (Assessment Factor (f))

The rating to be assigned here corresponds to the institution's composite compliance rating.

**Rating Level 1** -- The institution is in substantial compliance with antidiscrimination and other credit laws.

**Rating Level 2** -- The institution is in satisfactory compliance with antidiscrimination and other credit laws.

**Rating Level 3** -- The institution is in less than satisfactory compliance with antidiscrimination and other credit laws.

**Rating Level 4** -- The institution has an unsatisfactory record of compliance with antidiscrimination and other credit laws.

**Rating Level 5** -- The institution is in substantial noncompliance with antidiscrimination and other credit laws.

**V. Community Development and Other Factors**  
 (Assessment Factors (h), (k) and (l))

**Rating Level 1** -- The institution has taken affirmative steps to become aware of the full range of community development and redevelopment programs within its community. It is actively participating in the development or implementation of such programs to an extent consistent with its size and capacity and the nature and location of the community. In non-SMSAs, the institution has contacted appropriate government and non-government representatives to determine the level of community development needs in its area. It has then determined what areas are appropriate for its involvement and has initiated such involvement or has undertaken other types of activities not previously covered, which in the examiner's judgment reasonably bear upon the extent to which the institution is meeting the community credit needs.

**Rating Level 2** -- The institution is aware of community development/redevelopment programs within its community. It has advised appropriate community officials of its interest in participating in such programs and is already involved in some aspects of program planning

or implementation. Or, the institution is planning to undertake a specific activity designed to help meet community credit needs, which has not been covered in other categories, within six months.

**Rating Level 3** -- The institution is only vaguely aware of the community development/redevelopment activities in its community. The institution has taken little affirmative action to become involved in community development or to learn the specific features of different programs. Management appears receptive to becoming involved or investing in one or more programs but prefers to wait for a request to be initiated by community officials. At such time, the institution will consider possible participation. Management has periodically discussed various efforts to respond to community credit needs but a specific plan has not been developed.

**Rating Level 4** -- Management is unaware of the existence or nature of community development programs within its community and has expressed no interest in pursuing this area. Management has not developed any other programs, which were not covered previously, to help meet community credit needs. Management may be unaware of the CRA regulations' encouragement of institution involvement in community development/redevelopment programs.

**Rating Level 5** -- Management has repeatedly demonstrated its lack of interest in determining if community developments projects exist in its community. It has not expressed an interest in developing its own response to community credit needs.

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Request - Last five years allocation of regulatory staff resources to CRA enforcement.

Staff Hours Allocated to CRA Examinations

| <u>1983</u> | <u>1984</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> |
|-------------|-------------|-------------|-------------|-------------|
| 18,346      | 9,156       | 5,141       | 6,211       | 10,620      |

(Source: Division of Bank Supervision Progress Reports)

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RESPONSE TO REQUEST OF SENATOR GRAHAM FROM  
ROBERT L. CLARKE

Factors Used by the  
Office of the Comptroller of the Currency  
in Assessing Performance under the  
Community Reinvestment Act

The Community Reinvestment Act (CRA) encourages banks to help meet the credit needs of their local communities. Credit needs are unique to each community and banks may help meet those needs in different ways. Each bank is evaluated on the basis of its attempts to ascertain community credit needs and its efforts in helping to meet those needs. In conducting a CRA assessment, examiners tailor the related procedures to a bank's size, the level of management's knowledge and expertise regarding CRA's spirit and intent, and the characteristics of the bank's delineated community. The Office of the Comptroller of the Currency (OCC) assesses a national bank's performance under CRA by considering activities conducted as they pertain to the 12 assessment factors prescribed by 12 CFR 25.7(a) through (l). The following chart reflects these assessment factors and the corresponding procedures used by national bank examiners.

TWELVE ASSESSMENT FACTORS

- 1) Bank activities that ascertain the credit needs of its local community.
- 2) The extent of the bank's marketing and special credit-related programs to make community members aware of credit services available.
- 3) The extent of participation by the bank's board of directors in formulating CRA policies and in the bank's CRA performance.
- 4) Any practices intended to discourage applications for credit listed in the bank's CRA statement.
- 5) The geographic distribution of the bank's credit extensions, credit applications and credit denials.
- 6) Evidence of discriminatory or other illegal credit practices.
- 7) The bank's record of opening and closing offices and providing services at offices.

EXAMINATION PROCEDURES

- Obtain information from a review of bank records and interviews with bank staff. (Studies/customers/neighborhood groups/local government)
- Review bank's marketing program. (e.g. mortgage counseling programs/advertising/convenient hours/brochures)
- Review minutes of board of directors meetings and any other bank documentation available. (Bank staff awareness of CRA.)
- Review other fair lending examination programs (EOCA and Fair Housing Act). (Bank staff awareness of CRA/prescreening.)
- Initially rely on discussion with other examiners, review of examination reports and working papers of other programs. Review bank files and interview bank management. Additional reliance may be placed on geocoding.
- Review prior reports of examination/other examination programs currently being performed.
- Obtain information from the field or district office or from the bank's records. Review any public comments.

- 8) Bank participation in local community development and redevelopment projects or programs.  
  
Review written lending policy and procedure manuals. Interview lending officers. (HUD community development block grant program/ local neighborhood preservation efforts/CDC neighborhood housing services.)
- 9) The bank's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans, and small business or small farm loans within its community, or the purchase of such loans originated within its community.  
  
Review bank financial statements, HMMA disclosures, lending policy and procedure manuals. Interview bank staff.
- 10) Bank participation in governmentally insured, guaranteed, or subsidized loan programs for housing, small business or small farms.  
  
Review bank financial statements, HMMA disclosures, lending policy and procedure manuals. Interview bank staff. (FHA/VA/ FNMA mortgage loans/SBA loans/FHA Title I home improvement loans)
- 11) The bank's ability to meet community credit needs based on its financial condition and size, and legal impediments, local economic conditions, and other factors.  
  
Review examination workpapers and reports. Consider safety and soundness. (Small banks may lack resources)
- 12) Other factors that bear upon the extent to which a national bank is helping to meet the credit needs of its entire community.  
  
Consider factors such as bank purchases of state and municipal bonds, secondary mortgage market securities or whether the bank's policies promote efforts to assist existing residents in neighborhoods undergoing reinvestment and change.

Allocation of Resources by  
the Office of the Comptroller of the Currency  
to Enforcement of the  
Community Reinvestment Act

The Office of the Comptroller of the Currency (OCC) does not gather data on resources devoted specifically to the Community Reinvestment Act (CRA). Estimating that 20 percent of onsite consumer activities examination time is devoted to CRA, however, yields the following:

Examination Hours Devoted to CRA

| <u>1983</u> | <u>1984</u> | <u>1985</u> | <u>1986</u> | <u>1987</u> |
|-------------|-------------|-------------|-------------|-------------|
| 27,000      | 17,000      | 13,000      | 15,000      | 23,000      |

These estimates do not include offsite activities related to CRA such as meetings with community leaders and evaluation of corporate applications. During 1987, OCC staff met with over 70 public interest groups to discuss CRA related issues. Additionally, OCC provided speakers for over 30 seminars and training sessions sponsored by trade and state banking associations promoting compliance with CRA and other consumer related laws and regulations.



Senator GRAHAM. Let me ask another question of Governor Seger. Has the Fed ever denied an application based on CRA grounds? The statement was made yesterday they had not.

Ms. SEGER. It has not denied one based on CRA exclusively or even primarily. Again, there are a list of criteria that we must consider in looking at applications. That's one.

Senator GRAHAM. A former Governor of the Fed, Mr. Rice, wrote in one of the dissents in 1986:

The Board should not approve the application on the basis of promises of future performance when the bank's demonstrated long-term record has been and continues to be unsatisfactory.

#### PROMISES OF FUTURE PERFORMANCE

That's a statement of dissent which raises questions about the diligence of the Fed in both reviewing its standards of past performance and applying those standards to making current decisions.

Could you comment on that observation by Governor Rice?

Ms. SEGER. I remember that case involved a Chicago institution, that my good friend, Emmett Rice, did dissent on. We can approach these cases in two different ways. One is that you can, say when there's an application for a merger—or in this case establishing a holding company—"OK, based on your record as we view it today, it's not satisfactory. Therefore, this is turned down." That's one approach.

This particular application had been dragging on for a number of years, by the way, as this was being fought back and forth.

Instead of denying the application, you can say, "We ought to work with this organization, point out very clearly what their deficiencies are, and approve this"—in this case, the establishment of a holding company—"only if you make a commitment to remedy these deficiencies." And there would be a specific agreement between us and them, and we would monitor it to see that they in fact got their act together.

We also do this sometimes in regards to capital adequacy where you say, "Well, your capital as you stand now is barely adequate, but if you're going to engage in this merger then it clearly will no longer be adequate and you'd better count on raising 'x' millions of equity in the next 6 to 12 months." And that is a commitment and we condition the approval. So it's an approach not just used in the CRA area. But the idea is that we elicit—we hope we elicit—positive performance by doing this rather than just saying, "No, absolutely not." But we could go a different direction.

Senator GRAHAM. Well, your last statement is what I would call a performance standard in the financial side and it would seem to me that it would be appropriate for there to be similar performance standards on the social side which CRA speaks to. I would be interested in using that particular case as an example, if you could provide us with information as to (a) what did the Fed require in terms of this institution complying with its previous obligations; (b) what were the new obligations imposed upon this institution as a condition of receiving the approval that it requested; and (c) now some 18 to 24 months after the approval, what in fact has been the

record of that institution both on its preapplication obligations and those that attached at the time of application?

Ms. SEGER. OK. I'll have to get that from the Chicago Fed because that's in their district, but we will provide you with that.

Senator GRAHAM. Thank you.

[Information requested follows:]



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

May 24, 1988

MARTHA R. SEGER  
MEMBER OF THE BOARD

The Honorable Bob Graham  
United States Senate  
Washington, D.C. 20510

Dear Senator:

During the CRA oversight hearings on March 23, you asked for additional comments on the Advance Bancorp, Inc., order issued by the Board in October 1986, our resource allocations for the enforcement of CRA for a five-year period, and the performance standards that we use for the evaluation of CRA performance. I am writing to provide you with that information.

The Advance Bancorp, Inc., application involved a request to form a holding company by acquiring the South Chicago Savings Bank. South Chicago's CRA record had been less than satisfactory over a number of examinations; however, the trend at that time indicated that improvement was taking place. In connection with that application, Advance made a number of commitments that the Board felt would serve to further improve the Bank's record. Those commitments are enclosed (Attachment A). Advance was required to submit monthly reports to the Federal Reserve Bank of Chicago regarding its progress in fulfilling the commitments it had made. In the little over a year since the application was approved Advance has reported that South Chicago Savings has redelineated its community, is making more consumer loans to its community, is expanding its marketing efforts, and is generally taking steps to become more involved in the community. A detailed progress report is also included in Attachment A. Advance will continue reporting to the Reserve Bank until it is determined that each of the commitments has been fully met and the bank's performance is found to be satisfactory.

With respect to the resources allocated to CRA enforcement, I have also enclosed a chart (Attachment B) that shows the time spent on CRA examinations by Federal Reserve consumer affairs examiners to be between 12% and 13% of the time spent completing the entire consumer affairs examination at State member banks. Our data do not suggest that our resource allocations are decreasing. In fact the chart indicates that estimated dollars devoted to that portion of the consumer affairs examination have actually increased during this time period from \$707 in 1983 to \$1,023 in 1987 for each CRA review.

The Honorable Bob Graham  
Page Two

Also, these data do not include the resources devoted to the Federal Reserve's Community Affairs Program which indirectly supports our CRA efforts.

Our performance standards for evaluating a bank's CRA performance during the consumer affairs examination is described in the Uniform Interagency CRA Rating System adopted by the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency in 1981 (Attachment C). This system employs five performance categories or components from which examiners derive the overall composite CRA rating. The performance categories represent a grouping of the various assessment factors contained in the implementing regulation (Regulation BB) for CRA. The rating system provides the examiner with a description of the type of activities that are appropriate for each rating level within each of the performance categories. These descriptions are standards that guide the examiner in selecting the appropriate rating for an institution. In addition, I am enclosing a copy of the interagency examination procedures (Attachment D) which explain in more detail the kinds of reviews undertaken by our examiners when doing a CRA examination.

Your final question posed a distinction between a review emphasizing the bank's "process" for addressing CRA and one emphasizing the bank's "performance". As I stated in my testimony, I believe our examinations involve looking at both. However, it is not our policy to require banks to make particular kinds of loans of specified amounts in a given area in some relationship to the demographic make-up of the area. That, in my opinion, would be a form of credit allocation, which the Board has long held is properly a legislative function rather than a function this, or any other, agency should take upon itself.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,

*Martha R. Seger*

Enclosures

## Attachment A

**STATUS REPORT ON ADVANCE BANCORP'S FULFILLMENT  
OF COMMITMENTS MADE TO THE BOARD**

COMMITMENTS:

1. Bank will extend its community delineation to the north and west to include 46 new census tracts of which 44 have a Black population in excess of 80 percent and 28 of which are considered low-income.

Bank extended its community delineation as agreed. Under this extension, the total number of low- and moderate-income tracts increased from 5 to 29.

2. Bank will increase its loan-to-deposit ratio within five years and increase the number of loans made in its delineated CRA community to a level providing an equivalent ratio of the number of loan accounts both inside and outside its delineated community.

Bank's loan-to-deposit ratio has increased. The ratio was 33 percent on 9-30-86; 36 percent on 12-30-86; and 40 percent at 9-30-87. (When Applicant submitted its first application to the Federal Reserve Board, this ratio was 13 percent.) Number and dollar amounts of loans made within the community have also increased and now approximate the percentage of deposit accounts from within the delineated community.

3. Bank will expand and enlarge the percentage of Bank's consumer loans, including the percentage of consumer loans made within Bank's delineated community.

The percentage of consumer loans made within the delineated community has expanded. As of year-end 1987, mortgage loans originated within the community consisted of 71.9 percent of the number and 73.8 percent of the dollar value of the total mortgages outstanding. Consumer installment loans originated within the community consisted of 76.9 percent of the number and 80.2 percent of the dollar amount of total consumer loans outstanding.

4. Applicant and Bank will further study the needs of Bank's newly enlarged designated community by conducting an independent survey of consumer credit needs.

Bank contracted with an independent market research company to conduct a credit needs survey of its community. Staff from the Federal Reserve Bank of Chicago provided guidance to the company on the types of information needed from the survey. The survey was conducted in October, 1986.



5. Applicant and Bank will solicit advice from members of community organizations and invite their participation on Bank's Community Advisory Group.

Applicant expanded the number of members on its Community Advisory Group from 11 to 20. The new members represent those communities added when Bank increased its local delineation. (See commitment 1)

6. Applicant and Bank will increase substantially advertising to make known its lending program to its designated community. Bank has substantially increased the number and types of credit advertising over the last year. Bank has utilized community newsletters, newspaper, (including minority publications), and minority radio stations.

7. Applicant and Bank will participate in various community development programs.

Bank has participated in and contributed towards various community development programs, including a \$500,000 investment in the Community Investment Corporation's program in Chicago. In October of 1987, Bank hired a person for the community affairs function at the bank on a full-time basis.

## Attachment B

**Federal Reserve System  
Examination Resources Devoted to CRA**

| 1. Year                                                                                         | 1983     | 1984     | 1985     | 1986     | 1987*      |
|-------------------------------------------------------------------------------------------------|----------|----------|----------|----------|------------|
| 2. Number of CRA Reviews                                                                        | 764      | 709      | 765      | 637      | 557        |
| 3. Average Hours Spent on CRA Review                                                            | 11       | 10       | 9        | 10       | 10         |
| 4. Time Spent on CRA as Percent of Total Onsite Examination Time                                | 13%      | 12%      | 12%      | 13%      | 13%        |
| 5. Time Spent on CRA as Percent of Total Examination Time (Includes Bank and Reserve Bank Time) | 10%      | 9%       | 9%       | 9%       | 10%        |
| 6. Estimated System Dollars Allocated to CRA Portion of Examination (in thousands)              | \$540    | \$495    | \$513    | \$531    | \$570      |
| 7. Average Cost Per CRA Review                                                                  | \$707.00 | \$698.00 | \$671.00 | \$834.00 | \$1,023.00 |

\*Only preliminary 4th quarter data available for 1987.

## ATTACHMENT C

## UNIFORM INTERAGENCY COMMUNITY REINVESTMENT ACT (CRA) ASSESSMENT RATING SYSTEM

The purpose of the rating system is to provide a uniform means for regulatory agencies to identify quickly those institutions which require varying degrees of encouragement in helping to meet community credit needs. This provides a comprehensive and uniform system for evaluating the performance of federally regulated financial institutions examined under the various assessment factors of the Community Reinvestment Act and facilitates more uniform and objective composite CRA ratings.

The rating system ranks financial institutions on a scale from 1 through 5 with a "5" representing the lowest level of performance under the Act and, therefore, the highest degree of concern. Level "3" reflects performance which is less than satisfactory.

This system further employs five "performance categories" or components from which the overall composite CRA rating is derived. The performance categories represent a grouping of the various assessment factors contained in the implementing regulation for the Act. Each performance category is evaluated on a scale of 1 to 5 with a "5" representing the lowest level and therefore the worst performance. As explained later, each performance category includes a narrative description for each rating level.

## OVERVIEW

Each financial institution is assigned a composite CRA rating that is based upon the institution's performance in meeting various community credit needs. An examiner begins to evaluate the institution's record in meeting community credit needs by first reviewing its financial condition and size, legal impediments, and local economic conditions, including the competitive environment in which it operates. The type of community in which the institution is located will also have a significant bearing on how the institution fulfills its obligations to the community. Community credit needs will often differ with the specific characteristics of each local community, resulting in a variety of ways an institution may meet those needs. To maintain a balanced perspective, examiners must carefully consider information provided by both the institution and the community.

## COMPOSITE RATING SYSTEM

The performance categories are individually assigned a numeric rating. In assigning the overall composite CRA rating, the performance categories will be weighed and evaluated according to how well the institution meets the descriptive characteristics listed below.

Rating (1)

The institutions in this group have a strong record of meeting community credit needs. Both the Board of Directors and management take an active part in the process and demonstrate an affirmative commitment to the community. Institutions receiving this rating normally rank high in all performance categories. Such institutions have a commendable record and need no further encouragement.

Rating (2) --

Institutions in this group have a satisfactory record of helping to meet community credit needs. Institutions receiving this rating normally are ranked in the satisfactory levels of the performance categories. Institutions in this category may require some encouragement to help meet community credit needs.

Rating (3)

Institutions in this group have a less than satisfactory record of helping to meet community credit needs. The Board of Directors and management have not placed strong emphasis on the credit needs of the community. Institutions receiving this rating have mixed rankings surrounding the mid-range levels of the performance categories. Such institutions require encouragement to help meet the community credit needs.

Rating (4)

Institutions in this group have an unsatisfactory record of helping to meet community credit needs. The Board of Directors and management give inadequate consideration to the credit needs of the institution's community. Institutions receiving this rating generally rank below satisfactory in the majority of the performance categories. Such institutions require strong encouragement to help meet community credit needs.

Rating (5)

Institutions in this group have a substantially inadequate record of helping to meet community credit needs. The Board of Directors and management appear to give little consideration to the credit needs of the institution's community. Institutions receiving this rating generally rank in the lowest levels of the performance categories. Such institutions require the strongest encouragement to be responsive to community credit needs.

PERFORMANCE CATEGORIES

For purposes of evaluating an institution's CRA performance, the various assessment factors and criteria are grouped into the following "performance categories:"

### I. Community Credit Needs and Marketing

The institution is evaluated in this category on its activities in determining the credit needs of its community and in marketing its services. Included in this category are assessment factors (a), (b), and (c) in addition to how well the institution delineated its community and other technical compliance regarding the posted notice and maintenance of public files.

### II. Types of Credit Offered and Extended

The institution is evaluated in this category on the types and amounts of credit extended to the community and the degree to which those extensions are, in fact, helping to meet the community's needs. Included in this category are assessment factors (i) and (j) plus the institution's CRA statement.

### III. Geographic Distribution

The geographic distribution of the institution's loans and any practices meant to discourage applications are considered in this category, as well as the impact of the opening or closing of any offices and the services offered at those facilities. Included in the category are assessment factors (d), (e), and (g).

### IV. Discrimination or Other Illegal Credit Practices

The institution's compliance with anti-discrimination and other credit laws are evaluated in this category. The category includes assessment factor (f). The rating to be assigned here corresponds to the institution's composite compliance rating.

### V. Community Development

The institution is evaluated in this category on its participation in community development and/or other factors relating to meeting local credit needs. Included in this category are assessment factors (h), (k), and (l).

Each of the performance categories and the level of performance relating to each category are described in greater detail below.

#### PERFORMANCE CATEGORY RATING SYSTEM

- I. Community Credit Needs and Marketing (Assessment Factors (a), (b), (c), and Community Delineation)



o Rating Level 1

The institution has actively undertaken steps to determine community credit needs. These activities may include:

- a) identifying the demographic makeup (racial/ethnic groups and low- and moderate-income areas) of its community and making meaningful contacts with a reasonably full range of organizations (civil, religious, neighborhood, minority, etc.) to assist in determining the credit needs of all segments of its community;
- b) taking into consideration comments to the public file which describe existing unmet credit needs;
- c) contacting local government officials to identify any needs for private lender participation in existing or prospective community development or redevelopment programs. (In rural areas the local government body may be the County Supervisor's office or other appropriate office.)

The institution has actively undertaken marketing and credit related programs appropriate to the size and capacity of the institution and the nature and location of the community. These programs should reach all segments of its community. Community segments would include low- and moderate-income residents, small businesses and, where applicable, owners of small farms. Management has also established working relationships with real estate brokers and others who serve low- and moderate-income areas and who may provide assistance for small or minority businesses. There is evidence that senior management is aware of community concerns and activities.

o Rating Level 2

The institution has undertaken activities to determine its community's credit needs. As a result of these activities, the institution is generally aware of the credit needs within its community, including low- and moderate income areas. The institution has initiated a dialogue with community representatives such as local government, neighborhood, religious, and minority organizations, or small business and small farm organizations. The institution has undertaken marketing and credit related programs but the programs are not ongoing or comprehensive. Senior management demonstrates an awareness of community concerns and activities.

o Rating Level 3

The institution's activities to determine community credit needs are limited. The institution's employees may serve as volunteers on community organization boards and committees. However, the institution has not established a systematic method to determine how or if its employee's volunteerism assists the institution in meeting its CRA goals. The institution's advertising may be principally deposit oriented. In addition, the institution generally has made no efforts to market its services on an equal basis to all segments of its community. Marketing and credit related programs do not include a mechanism for reaching low- and moderate-income areas within the delineated community. The institution's marketing effort does not adequately focus on marketing the types of credit for which the institution has identified a need (or a need is otherwise apparent.) There may also be some concern about the community delineation.

o Rating Level 4

The institution's efforts to determine community credit needs are very limited and fail to address major segments of its community. Management has not established a dialogue with organizations representative of the community, including any which represent low- and moderate-income or minority neighborhoods within the delineated community. The institution's marketing and credit related programs are limited or poorly conceived. There may also be some concern about the community delineation. Senior management is unaware of special needs of low- and moderate-income residents, small business and small farms.

o Rating Level 5

The institution has not undertaken any meaningful efforts to determine community credit needs. Management has limited knowledge regarding the community's demographic characteristics. The institution's marketing and credit related programs are either non-existent or have repeatedly excluded low- and moderate-income areas within the delineated community. There may also be some concern about the community delineation.

II. Types of Credit Offered and Extended (Assessment Factors (i), (j), and CRA Statement)

o Rating Level 1

The institution has investigated the need for different types of credit within its community such as residential mortgage loans, housing rehabilitation and home improvement loans, and small business or farm loans, including the need for private, as well as government-insured, guaranteed or subsidized forms of such loans. It has then made an explicit effort to assure that its loan policies are responsive to the needs and has examined the extent to which it and other institutions within the community are meeting the need for such loans. The institution's CRA Statement lists the type of loans found to be needed in the community. The involvement by the institution in the making of each type of loan listed in the statement demonstrates an affirmative effort to make such loans and to do its share in meeting existing needs, consistent with its resources and capabilities.

o Rating Level 2

The institution's CRA Statement and loan portfolio indicate that it has investigated the need for residential mortgage loans, housing improvement/rehabilitation loans, small business and farm loans, and private, as well as government-insured, guaranteed, or subsidized forms of such loans within its community. It has made an explicit effort to assure that its loan policies are responsive to the needs found. The institution's performance in this category is distinguished from a 1-rated institution primarily in the extent to which it is making the availability of loans and/or in the degree to which the types and volume of loans being made match the community's most pressing credit needs.

o Rating Level 3

The institution may not be offering one or more types of credit listed in its CRA Statement, despite a capacity to do so. The institution's loan portfolio and other sources, including peer analysis, may indicate that the institution's share of loans of a type or types identified as needed in the community, including any low- and moderate-income areas, is marginal or somewhat below average, particularly with respect to extensions for residential housing, small business or farm credit.

o Rating Level 4

The institution's record of offering and of making loans reveals that it is doing relatively little to help meet known or demonstrated credit needs for residential, small business or small farm credit, particularly for residents of low- and moderate-income areas. Its participation in private, as well as government-insured, guaranteed or subsidy loan programs is either perfunctory or nonexistent, under circumstances where the need for such loans has been identified and the lender can articulate no objective supportable reason for its low level of participation.

o Rating Level 5

The institution is unwilling to adapt its credit offerings to serve demonstrated unmet credit needs in its community, particularly for housing, small business or small farm credit. This rating would be particularly appropriate where the lender's failure to meet these needs was cited in a previous examination.

III. Geographic Distribution (Assessment Factors (d), (e), and (g))

o Rating Level 1

The geographic distribution of the institution's credit extensions, applications and denials indicate that the institution is making the substantial portion of its credit available to all areas within its community. The institution has reviewed the geographic distribution of its credit extensions, applications and denials in a manner appropriate to the size and capacity of the institution and the nature and location of the community. Where that review has disclosed a very low level of applications from or loans to a particular neighborhood or area, especially low- or moderate-income areas, the institution has reviewed its marketing practices to determine what, if any, impact they may have had on the distribution. Where appropriate, the institution has either revised its marketing practices or lending policies or both. The institution's offices are reasonably accessible to all segments of its community and banking hours are tailored to meet the convenience and the needs of its customers. Finally, the institution considers, in advance, the potential impact of opening and closing offices on its ability to continue offering equal services throughout its community.

o Rating Level 2

The geographic distribution of the institution's credit extensions, applications, and denials indicate that the lender is making credit available to all areas within its community. The institution has taken steps to eliminate unreasonable lending patterns disclosed by examiners or which have resulted from the review of the institution's policies or practices. The geographic distribution of applications reveals no pattern suggestive of any practice of discouraging or "prescreening" applications. The institution's record of opening and closing offices and the provision of services at its offices do not reflect any disparate treatment of minority or low- and moderate-income neighborhoods. Offices are reasonably accessible to all segments of its delineated community. Services and banking hours are periodically reviewed to assure accommodation of all segments of the delineated community.

o Rating Level 3

The geographic distribution of the institution's credit extensions, applications and denials may suggest unreasonable lending patterns. Management has not attempted to review its lending policies and procedures or to analyze the institution's lending patterns within its community. The institution's record of opening and closing offices and its provision for services at its offices may indicate a disparity of treatment between certain areas within its community. Such a disparity is isolated and not an overall intentional pattern or practice. Management has plans to undertake immediate steps to restore reasonably equal service to any affected areas.

o Rating Level 4

The geographic distribution of credit extensions, applications, and denials reveal unreasonable lending patterns, particularly in low- and moderate-income neighborhoods or areas of racial/ethnic concentration. The geographic distribution of applications may indicate prescreening applications. The institution's record of opening and closing offices and the provision of services at its offices may suggest a pattern of disparate treatment of minority or low- and moderate-income neighborhoods. The record might portray an institution that has systematically sought to close or curtail services at offices serving minority or less affluent neighborhoods while opening new offices in developing, majority or upper-income areas.



o Rating Level 5

The geographic distribution of credit extensions, applications, and denials reveals extensive systematic unreasonable lending patterns. The institution has adopted loan policies and procedures, such as unjustifiably high minimum mortgage amounts or down payments or restrictions based on the age of property which have or can reasonably be expected to have a significantly adverse impact on loan availability in low- and moderate-income or minority neighborhoods. The institution's record of opening and closing offices and the provision of services at its offices suggest a continuing pattern of disparate treatment of minority or low- and moderate-income neighborhoods. Where this was previously cited, management has not taken any corrective action.

IV. Discrimination or Other Illegal Credit Practices (Assessment Factor (f)).

The rating to be assigned here corresponds to the institution's composite compliance rating.

o Rating Level 1

The institution is in substantial compliance with anti-discrimination and other credit laws.

o Rating Level 2

The institution is in satisfactory compliance with anti-discrimination and other credit laws.

o Rating Level 3

The institution is in less than satisfactory compliance with antidiscrimination and other credit laws.

o Rating Level 4

The institution has an unsatisfactory record of compliance with antidiscrimination and other credit laws.

o Rating Level 5

The institution is in substantial noncompliance with antidiscrimination and other credit laws.

V. Community Development and Other Factors (Assessment Factors (h), (k), and (l))

o Rating Level 1

The institution has taken affirmative steps to become aware of the full range of community development and redevelopment programs within its community. It is actively participating in the development or implementation of such programs to an extent consistent with its size, capacity, and the nature and location of the community. In non-SMSAs, the institution has contacted appropriate government and nongovernment representatives to determine the level of community development needs in its area. It has then determined what areas are appropriate for its involvement and has initiated such involvement or has undertaken other types of activities not previously covered, which in the examiner's judgment reasonably bear upon the extent to which the institution is meeting the community credit needs.

o Rating Level 2

The institution is aware of community development/redevelopment programs within its community. It has advised appropriate community officials of its interest in participating in such programs and is already involved in some aspects of program planning or implementation. Or, the institution is planning to undertake a specific activity designed to help meet community credit needs, which has not been covered in other categories, within six months.

o Rating Level 3

The institution is only vaguely aware of the community development/redevelopment activities in its community. The institution has taken little affirmative action to become involved in community development or to learn the specific features of different programs. Management appears receptive to becoming involved or investing in one or more programs, but prefers to wait for a request to be initiated by community officials. At such time, the institution will consider possible participation. Management has periodically discussed various efforts to respond to community credit needs, but a specific plan has not been developed.

## Rating Level 4

Management is unaware of the existence or nature of community development programs within its community and has expressed no interest in pursuing this area. Management has not developed any other programs, which were not covered previously, to help meet community credit needs. Management may be unaware of the CRA regulation's encouragement of institution involvement in community development/redevelopment programs.

## o Rating Level 5

Management has repeatedly demonstrated its lack of interest in determining if community development projects exist in its community. It has not expressed an interest in developing its own response to community credit needs.

## HOUSING AND COMMUNITY DEVELOPMENT ACT OF 1980

## EXAMINATION PROCEDURES

The Board shares the concern of Congress that widespread conversions or rental housing may reduce the housing options available to certain citizens, particularly low-income, elderly, and handicapped tenants. Therefore, examiners should:

1. Notify State member banks and various civic, religious, and neighborhood organizations of the sense of the Congress. The number and types of groups contacted with which examiners discuss the Act should be recorded in the workpapers.
2. Ask city planning officers for a list of condominium conversions and who is providing the financing for the conversion. If such a project is in-process and a State member bank is financing the conversion, the examiner should counsel these banks about the expression of public policy.
3. Recognize the efforts of lenders who participate in innovative methods of revitalizing neighborhoods in ways that help minimize displacement of tenants.

## COMMUNITY REINVESTMENT ACT EXAMINATION PROCEDURES

The following statement, which contains procedures used to examine an institution for compliance with the Community Reinvestment Act and regulation was developed by an interagency task force representing the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, and Federal Reserve Board. This is the first time the four regulatory agencies have combined their efforts to develop uniform procedures. Any modifications or alterations of these procedures in the future will be made on the same basis.

## INTRODUCTION

This statement was prepared with several objectives in mind.

- o To provide specific examination procedures.
- o To indicate the general scope, character, and intent of the Community Reinvestment Act (CRA) examination.
- o To provide guidance for the examination of diverse institutions in varied circumstances.
- o To make publicly available a self-contained general statement on examination procedures.

Premises

The statement is based on several premises.

- o The CRA review will be integrated into existing examination procedures, although precisely how this will be done is left to each agency.
- o Each agency will adopt a reporting method consistent with its current procedures. The respective "report" or "comment" page will reflect similar procedures and will be furnished to the institutions on a confidential basis.
- o The examiner will discuss with management the overall findings of assessment along with supporting details.

## OVERVIEW

## A. Community Reinvestment Act

The Community Reinvestment Act is intended to encourage regulated financial institutions 1/ to help meet the credit needs of their entire

1/ The term "regulated financial institution" means a commercial bank, mutual savings bank, or a savings and loan association which is Federally insured.

communities, including low- and moderate-income neighborhoods, while preserving the flexibility necessary for the institutions to operate in a safe and sound manner.

Encouragement is to be provided by four supervisory agencies, 2/ each of whom is required:

- o To use its examination authority to encourage an institution to help meet the credit needs of its entire community, consistent with the safe and sound operation of the institution.
- o To assess, in connection with its examination, an institution's record of helping to meet the credit needs of its entire community.
- o To take that record into account in evaluating an application for a charter, deposit insurance, branch or other deposit facility, office relocation, merger, or holding company acquisition of a regulated financial institution.

Proponents of the Community Reinvestment Act were concerned among other things with situations in which local lenders reportedly exported local deposits to other areas despite sound local lending opportunities. Such disinvestment was considered a threat to community and neighborhood vitality. Lenders are, therefore, encouraged to give particular attention to local housing and development needs of urban and rural areas. Increased lender sensitivity to such lending needs would help preserve, rehabilitate, and revitalize such neighborhoods. Moreover, even though credit for local housing and community development was emphasized, it was realized that other types of credit provide community facilities and services necessary for neighborhood vitality and, more generally, a healthy local community.

The act is not intended to inject hard and fast rules or ratios into the examination or application process. Rather the law contemplates a judgmental evaluation of a lender's record in order to accommodate varying circumstances. Nor does the act require financial institutions to make high risk loans that jeopardize their safety. Rebuilding and revitalizing communities are viewed as beneficial for both communities and financial institutions.

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2/ The four agencies are: Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Home Loan Bank Board, and Federal Reserve Board.



## B. CRA Regulation

The implementing regulation requires the board of directors of each institution to adopt and at least annually review a Community Reinvestment Act Statement. The Statement must include: (1) a delineation on a map of each local community served by the institution, (2) a list of specific types of credit that the institution is prepared to extend within each local community, and (3) a copy of the Community Reinvestment Act Notice. The regulation also encourages each institution to include in its Statement a description of its efforts to ascertain and help meet community credit needs.

An institution must provide in each office a Community Reinvestment Act Notice, the exact wording of which is prescribed in the regulation. The public notice indicates that the CRA Statement is available, that written comments on the Statement and the institution's community lending performance may be submitted to the institution or its supervisory agency, that a file of such comments is publicly available, and that the public may request announcements of applications covered by CRA from the supervisory agency.

Each institution must keep a public file of CRA Statements in effect and CRA-related public comments received during the past two years or since the effective date of the regulation (November 6, 1978), whichever period is less.

The CRA regulation sets forth a list of factors that the agency will consider in connection with its examination in making its assessment of each institution's record of helping to meet community credit needs, including those of low- and moderate-income neighborhoods. Institutions are not required to adopt particular activities on the list since the regulation is designed to allow each institution considerable flexibility in determining how it can best help to meet the credit needs of its entire community in view of its particular skills and resources.

The agency's assessment of an institution's CRA record will be taken into account in evaluating a variety of applications by the institution.

In essence, the regulation encourages institutions to become aware of the full range of credit needs of their communities and to offer the types of credit and credit-related services that will help to meet those needs. However, the regulation does not require institutions to offer particular types or amounts of credit.

## BACKGROUND FOR EXAMINATIONS

In connection with examinations, the agency is required to assess an institution's CRA record. The examiner plays a major role in this assessment process, with other agency personnel such as community affairs specialists and applications staff complementing the examiner's efforts.

### Judgmental Process

In conducting a CRA examination, the examiner is expected to adjust the CRA procedures on a case-by-case basis to accommodate institutions that vary in size, expertise, and locale. Community credit needs will often differ with the specific characteristics of each local community, and institutions may serve these local credit needs in a variety of ways. Each institution should be evaluated on the basis of its attempts to ascertain, its determination to help meet, and its performance in helping to meet, community credit needs in the context of its resources and local circumstances.

### Balanced Viewpoint

The examiner should maintain a balanced perspective in conducting a CRA examination. The examiner cannot normally conclude on the basis of any one factor that an institution is or is not helping to meet the credit needs of its local community or communities. Nor can the examiner adequately assess a lender's performance on the basis of any one source of information, data, or opinion. For that reason, the procedures are designed to ensure that information from both the institution and the community are objectively reviewed and evaluated.

### Institution's Input

The examination procedures give each institution the opportunity to demonstrate that it is having a beneficial influence on its local community or communities. Institutions that are helping to meet community credit needs are proud of that fact and will be of substantial assistance to the examiner in assessing their performance.

### Examiner Encouragement 3/

When appropriate, an examiner should encourage an institution to improve its CRA record by discussing with management various ways in which the institution may strengthen its performance. The examiner should not, however, insist upon any specific action by the lender, such as the making of a certain type of loan, which would interfere with an institution's responsibility for the establishment of its policies.

### Examination Burden

The examiner must be careful not to unduly burden the institution since Congress did not intend to impose significant new reporting or record-

3/ The Federal Home Loan Bank Board will accomplish these items through the joint efforts of both field examiners and supervisory agents.

keeping requirements on financial institutions. The examiner should normally request only required records and other existing information, but the scope of the review must always be sufficient for an adequate assessment.

Institution's Financial Condition and Size, and  
Legal Impediments and Local Economic Conditions

An institution's ability to help meet community credit needs is influenced by its financial condition and size, as well as by legal impediments and local economic conditions under which it operates. An examiner must take these considerations into account in assessing a lender's performance and in providing encouragement.

Technical Compliance with the Regulation

The examiner will check for compliance with the specific requirements of the regulation. However, compliance with procedural requirements does not imply that a lender has been serving local credit needs. The converse is also true: noncompliance with a technical requirement does not necessarily mean that an institution is not helping to meet community credit needs. The examiner must not lose sight of the intent of the statute in checking for technical compliance with the regulation. The entire examination is designed primarily to determine the extent to which a lender has helped and is helping to meet community credit needs.

Communication, Community Development, and  
Low- and Moderate-Income Neighborhoods

In assessing the record, the examiner should bear in mind the special emphasis placed on effective communication and community development activities. With respect to communication, the premise is that community needs which can be met on a safe and sound basis are more likely to be met when the community is aware of the types of credit available and the lender is well informed about community credit needs. Hence, efforts to ascertain community credit needs and to publicize available credit services, including measures to identify the credit needs of, and to advertise in, low- and moderate-income neighborhoods, are encouraged. The examining staff is authorized to conduct interviews with community members when such action would be appropriate in determining community awareness of the institution's credit services and local perception of credit needs.

CRA also focuses on activities that foster development within the entire community, including low- and moderate-income neighborhoods. Consequently, housing-related extensions, participation in community development programs, and small business financing, including loans to small farms, are viewed favorably.

#### SELECTED FEATURES OF CRA EXAMINATIONS

This section is designed to provide the examiner with a better understanding of selected features of the CRA examination. Each agency will provide additional training and instructional aids as needed to carry out the purposes of the CRA examination.

##### The CRA Statement

An institution must prepare a separate CRA Statement for each local community it serves, including a delineation of the relevant local community. It does not necessarily follow, however, that the Statement prepared for each local community must contain a unique list of available credits. A lender serving several local communities may elect to prepare Statements that contain lists of credits which are similar or identical for the local communities served. Since some credit needs are common to many local communities, such an approach would be consistent with the intent of CRA. There are other ways for a multi-community lender to satisfy this requirement. The examiner need not be especially concerned with the specific method employed by a multi-community institution so long as it makes a good faith effort to inform members of each local community about their community's boundaries and the types of credit extended there.

##### Reasonableness of Community Delineation

Each institution must delineate the local community or communities that it serves. For instance, a statewide branching institution would serve a number of "local communities," the sum total of which would constitute its "entire community." Further, more than one office of an institution may serve the same local community. For example, an institution may have offices throughout a city and its suburbs and consider that entire metropolitan area to be the local community for those offices. Each community delineation must, of course, include the contiguous areas surrounding each office or group of offices.

Because many factors influence the size and shape of a lender's community, the regulation provides guidelines to assist each institution in defining its local community or communities.

The first guideline suggests the use of widely recognized existing boundaries such as those of SMSA's or counties for delineating an institution's local community or communities. Such boundaries frequently constitute a reasonable approximation of the institution's local community.

In general, a local community based on existing boundaries should be no larger than an entire SMSA <sup>4/</sup> or a county in a non-SMSA area. (The agencies have used such areas to approximate relevant markets for evaluating the competitive effects of mergers and holding company acquisitions.) If an institution has offices in more than one such area, it will have more than one local community. When an institution has an office near the boundary of an SMSA or county, it should include those portions of adjacent counties that it serves. In rural areas, a local community may sometimes encompass more than one county, but, generally, institutions should not use states or regions of states to delineate local communities. A small institution that serves an area smaller than an SMSA or county may define its community to be a part of the SMSA or county. An institution may make adjustments in the community delineation in the case of areas divided by state borders, or significant geographic barriers, or areas that are extremely large or of unusual configuration.

The second guideline proposes the use of effective lending territory, a concept more familiar to savings and loan associations than to commercial and mutual savings banks. The effective lending territory is that local area or areas around each office or group of offices where the lender makes a substantial portion of its loans and all other areas equally distant. If an institution employs its effective lending territory, it is encouraged to follow existing boundaries where practical.

One should not conclude from this guideline that each office necessarily serves a separate and distinct local community because each office typically has a different, though possibly partially overlapping, effective lending territory. If an institution is represented throughout a trade or market area, it may be more reasonable to use that area as its local community.

Finally, the regulation allows an institution to use any other reasonably delineated area. An institution is thus given substantial leeway in specifying its local community so long as the definition is reasonable; that is to say, the institution can provide a sensible rationale for the delineation and has not arbitrarily excluded any low- and moderate-income neighborhoods.

<sup>4/</sup> Except in the New England states, a Standard Metropolitan Statistical Area (SMSA) is a county or group of counties which contain at least one city of 50,000 inhabitants or more, or "twin cities" with a combined population of at least 50,000. In addition to the county or counties containing such a city or cities, contiguous counties are included in an SMSA if, according to certain criteria, they are socially and economically integrated with the central city. In the New England states, SMSA's consist of towns and cities instead of counties.



### Low-and-Moderate Income Neighborhoods

In determining whether the community definition is reasonable, the examiner must be alert to situations where low-and moderate-income neighborhoods are gerrymandered out of a delineated area. Moreover, in assessing an institution's record, the examiner should focus particular attention on the lender's performance in low-and moderate-income neighborhoods within a local community.

Low-and moderate-income neighborhoods may be identified in most cases in a manner similar to the approach taken by HUD in administering the Community Development Block Grant Program. For this purpose, such neighborhoods are approximated by those census tracts in an SMSA where median family income is less than 80 percent of median family income for the entire SMSA. Unfortunately, these data are not available for non-SMSA counties, and the latest complete census income data by SMSA census tract were collected in 1970.

Non-SMSA areas, especially rural areas, present a particular problem in identifying low-and moderate-income neighborhoods. In those areas the examiner may have to rely on personal knowledge of the area, physical inspection as necessary, discussion with institution personnel, or a combination of these.

### Small Business Lending

Small business loans represent one type of credit which the agencies believe is directly related to the purposes of the CRA. In considering small business lending, the examiner should not be concerned with any hard and fast or precise definition of what constitutes a small business. Instead, the examiner should regard as small business lending any loans to local firms whose access to credit is limited to local sources because of the firms' size.

### EXAMINATION OBJECTIVES

1. To determine if the institution's policies address the intent of the Community Reinvestment Act.
2. To encourage sensitivity and responsiveness of the institution to community credit needs. 3/
3. To determine that the institution is complying with the requirements of the CRA regulation.
4. To determine the reasonableness of the institution's delineation(s).

5. To assess the institution's record in helping to meet the credit needs of its entire community, including low-and moderate-income neighborhoods, 5/ consistent with the safe and sound operation of the institution.
6. To develop, organize and report information on the institution's record for use in the supervisory and application process.

#### EXAMINATION PROCEDURES

The following steps should be performed at each examination:

1. Ascertain from institution personnel what steps the institution has taken or plans to take which indicate whether it is helping to serve the credit needs of its local community or communities.
  2. Obtain the following:
    - a. Minutes of the board of directors' meetings, particularly those dealing with the adoption, review and revision of all CRA statements.
    - b. The institution's Files of Public Comments and recent CRA Statements.
    - c. Comment letters received by the supervisory agency.
    - d. The institution's loan and investment policy and procedural manuals, along with other manuals relating to the CRA.
  3. Review minutes of directors' meetings and verify that the board has:
    - a. Adopted a CRA Statement for each delineated community.
    - b. Reviewed each Statement at least annually.
    - c. Acted upon any material change in each Statement at the first regular meeting of the Board following the change.
  4. Review and analyze the Public Files for:
    - a. Any signed written comments received from the public during the past two years that specifically relate to any CRA Statement or to the institution's performance in helping to meet the credit needs of its community or communities. Determine that the comments do not contain any material specifically prohibited by the regulation. However, the examiner shall consider letters containing any such material.
- 5/ Examiners will be supplied information to help indicate which areas may be low-and moderate-income neighborhoods.

- b. Any responses to the commentors that the institution may have made.
- c. All CRA Statements in effect during the past two years.

Note: Inherent in the process of reviewing public files is the option of contacting commentors and/or community members to the extent deemed necessary.

5. Review each CRA Statement in effect during the past two years and:

- a. Ascertain if the institution's delineation of its local community or communities is reasonable. Give special attention to the following:
  - 1. Considerations used by the institution to define its community.
  - 2. Community boundaries that are sharply asymmetrical, too narrowly drawn, or so broad that the institution fails to focus on its local community.
  - 3. Whether any low- and moderate-income neighborhoods have been arbitrarily excluded.
  - 4. Public comments specifically relating to the reasonableness of the institution's delineation(s).
  - 5. Any relevant information obtained from other work programs that have been performed.

If a question remains regarding the reasonableness of the community delineation, a review of the community boundaries drawn by comparable local institutions may provide useful information.

- b. Review and analyze for completeness specific types of credits within certain categories that the institution is prepared to extend within the local community. Determine if the types of credit in the CRA Statement correspond to the types of credit actually being extended by the institution. Request explanation of any differences. If feasible and appropriate, review the list of available credits prepared by comparable local institutions.
- c. Determine that a copy of the CRA Public Notice is included.
- d. Analyze any of the following optional information that the institution may have included:
  - 1. A description of how its efforts, including special credit-related programs, help to meet community credit needs.

2. A periodic report regarding its record of helping to meet community credit needs.
3. A description of its efforts to ascertain the credit needs of its community, including efforts to communicate with members of its community regarding credit services.
4. Any other material the institution may have included.
6. Analyze the institution's policies, procedures, and operating practices to determine if the institution:
  - a. Provides the CRA Public Notice in a manner specified by the regulation. (An institution may reprint this notice as a poster or flyer to be placed in its lobby. The notice requirement may also be satisfied by making the CRA Statement, which includes the notice, available as a brochure in the lobby.)
  - b. Makes all CRA Statements available to the public as provided by the regulation.
  - c. Makes the Public Comment files readily available for public inspection as provided in the regulation.
7. Review the institution's credit underwriting and appraisal criteria and terms and conditions of loans to determine if they are being used for exclusionary purposes, contrary to the objectives of CRA.

#### 8. Assessment Factors

- a. Activities conducted by the institution to ascertain the credit needs of its community, including the extent of the institution's efforts to communicate with members of its community regarding the credit services being provided by the institution.

Ascertain from institution records and through the interviewing process the extent to which the institution has communicated with members of its local community or otherwise has attempted to determine such needs. Pertinent factors may include:

1. Management review of written, signed public comments received in response to the institution's CRA Statement(s).
2. Studies conducted or reviewed by the institution concerning local credit needs.
3. The extent of the institution's efforts to communicate with members of its community regarding the credit services it is providing. Such members might include customers of the institution, the PTA, merchants' associations, religious organizations,

coalitions of neighborhood organizations, local civil rights, consumer, minority, and non-English speaking groups, housing counseling service centers, community development corporations, nonprofit housing development corporations, and local development corporations.

4. The institution's communications with private organizations as may be identified by the Office of the Assistant Secretary for Neighborhoods, Voluntary Associations and Consumer Protection at HUD.
  5. The institution's review of the local government's Community Development Plan and Housing Assistance Plan prepared in conjunction with HUD's Community Development Block Grant Program.
  6. Economic forecasting, as developed or used by the institution.
- b. The extent of the institution's marketing and special credit-related programs to make members of the community aware of the credit services offered by the institution.

Review the institution's marketing program and determine if it is adequately designed to encourage applications for loans in its community, particularly low- and moderate-income neighborhoods. Pertinent factors may include:

1. Any working relationships the institutions may have with real estate brokers or others who service low- and moderate-income neighborhoods.
2. Mortgage counseling programs and programs of management assistance for small or minority businesses.
3. Development and participation in mortgage review boards.
4. Credit and credit-related services in low- and moderate-income neighborhoods compared to such services in other neighborhoods served by the institution.
5. Use of institution representatives for seeking out potential housing-related and small business demand in low- and moderate-income neighborhoods.
6. Advertising the types of loans the institution is willing to make in media likely to reach low- and moderate-income individuals in the institution's local community or communities.
7. Availability of convenient hours in offices accessible to residents of low- and moderate-income neighborhoods.



8. Use of informational brochures and participation in other educational efforts.
- c. The extent of participation by the institution's board of directors in formulating the institution's policies and reviewing its performance with respect to the purpose of the Community Reinvestment Act.
- d. Any practices intended to discourage applications for types of credit set forth in the institution's CRA Statement(s).

Review other fair lending examination programs, particularly as they pertain to interviewing and prescreening. Additionally, ascertain the following:

1. Whether administrative loan personnel and loan officers are aware of the CRA and the requirements of the implementing regulation.
2. Whether lending officers are aware of the institution's delineation of its local community or communities and its policies, if any, with respect to its commitment to help meet the credit needs of its entire community, including low- and moderate-income neighborhoods.
3. Whether loan officers are aware of the types of credit the bank offers to members of its local community or communities.
4. Whether public contact personnel are aware of the availability of the institution's CRA Statement(s) and Files of Public Comments.
5. Whether the institution is prepared to extend types of credit in some local communities or neighborhoods but not in others. An explanation of any difference should be requested from the institution.
6. The extent to which the institution is willing to make loans in its delineated local community or communities, utilizing information derived in (e.) below. Special attention should be given to specific reasons why loan applications have been denied, whether or not such denial has been on a prohibited basis.
7. Whether loan officers or other public contact personnel prescreen potential applicants from obtaining loans that the institution has stated it is willing to make, particularly applicants from low- and moderate-income neighborhoods.
- e. The geographic distribution of the institution's credit extensions, credit applications, and credit denials.

Determine whether there is any indication of a geographic distribution of credit extensions, applications for credit, and credit

denials which would signify failure to serve selected areas of local communities, particularly low- and moderate-income neighborhoods. Initial reliance may be placed upon discussion with other examiners, review of reports of examination, and review of working papers from other programs performed. For those institutions located in Standard Metropolitan Statistical Areas (SMSA's), additional reliance may be placed upon other fair lending examination programs for ascertaining the volume and location of housing-related credits.

For loans made outside SMSA's, particularly with respect to institutions that are not located in such areas, interview management and review internal files to determine the extent of housing-related lending in low- and moderate-income neighborhoods and the extent to which the institution has not extended such credit in those areas.

Reliance may be placed upon geocoding of credit extensions, credit applications, and credit denials. Where the institution is required to maintain registers or logs of applications, the examiner will review the registers or logs to determine the geographic distribution of loans, applications and denials. In conjunction with other fair lending examination programs, it may be necessary to analyze further the geographic distribution of small business loans, including loans to small farms within the institution's local community.

f. Evidence of prohibited discriminatory or other illegal credit practices.

Review the prior reports of examination and, in conjunction with other examination programs, determine the extent to which the institution is currently complying with the law.

g. The institution's record of opening and closing offices and providing services at offices.

Information can be provided by the supervisory authority or obtained from the institution's records. Ascertain the impact of such activities through the interviewing process and the review of public comments with particular focus on low- and moderate-income neighborhoods.

h. The institution's participation, including investments, in local community development and redevelopment projects or programs.

Review written lending policy and procedural manuals and interview lending officers to ascertain whether current programs include, or if the institution has considered involvement in, programs for satisfying potential credit needs such as the following:

- o HUD's Community Development Block Grant Program.
- o Local neighborhood preservation efforts.

- o Community Development Corporations.
- o Financing for Local Development Corporations.
- o Neighborhood Housing Services.
- o Investments in, or coordination with, Minority Enterprise Small Business Investment Corporations (MESBIC's) or Small Business Investment Corporations (SBIC's) in providing loans to business for which equity or subordinated debt is provided by MESBIC or SBIC.
- o Purchase of securities of State and local housing agencies.

- i. The institution's origination of residential mortgage loans, housing rehabilitation loans, home improvement loans, and small business or small farm loans within its community, or the purchase of such loans originated in its community.

Review the institution's financial statements, other appropriate records including Home Mortgage Disclosure Act Statements, its written lending policy and procedural manuals, and interview lending personnel to ascertain whether the institution has originated or purchased such loans or has plans to do so.

- j. The institution's participation in governmentally-insured, guaranteed, or subsidized loan programs for housing, small business or small farms.

This information may be obtained in ways similar to the ones in assessment factor (i) above. Examples of such government loan programs include:

- o FHA/VA/FHEA mortgage loans to members of its community or communities.
- o FHA Title I home improvement loans.
- o SBA loan guaranty programs.
- o Similar programs conducted by State or local agencies.

- k. The institution's ability to meet various community credit needs based on its financial condition and size, and legal impediments, local economic conditions, and other factors.

The financial condition of the institution may be ascertained from discussion with other examiners or review of examination work papers and reports.

Small institutions may not have the specified staff or financial resources needed to participate in some loan programs.

Legal restrictions on permissible activities, interest rates, and branches may affect a lender's ability to help meet community credit needs.

Adverse economic conditions caused by local or general economic difficulties may force an institution to temporarily curtail its lending activities.

Other factors may affect an institution's ability to help meet community credit needs.

1. Other factors that in the agency's judgment reasonably bear upon the extent to which the institution is helping to meet the credit needs of its entire community.

Pertinent factors may include:

- a. Purchases of state and municipal bonds, secondary mortgage market securities or such other activities when they further special purposes in the community, such as the construction or rehabilitation of low- and moderate-income housing or other neighborhood or community development, or are issued by municipalities or other local public financing units which do not have access to the capital markets.
  - b. Whether the institution's policies promote efforts to assist existing residents in neighborhoods undergoing a process of reinvestment and change.
  - c. Any other relevant factors.
9. Determine if the record of performance of the institution's facilities demonstrates its recognition of its continuing and affirmative obligation to help meet the credit needs of its entire community including low- and moderate-income neighborhoods, consistent with safe and sound operation.
  10. Review the following with management:
    - a. The extent to which the bank is helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation.
    - b. Suggestions that might better enable the institution to help meet the credit needs of its entire community.
    - c. Procedural violations of the regulation.
    - d. Deficiencies or exceptions in policies or practices. 3/

11. The examiner staff 3/ will prepare a narrative statement for the Examination report which will include:

a. Reasonableness of Community Delineation(s)

Under the above heading, discuss the reasonableness of the community delineations, including any suggestion made to management.

b. Assessment

Under the above heading, provide a narrative assessing the institution's record of performance in helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation of the bank. In developing this narrative, give particular consideration to each of the assessment factors ((a) through (l) of the CRA regulation). The narrative should include any suggestions made to management that might better enable the institution to help meet such credit needs.

c. Noncompliance and Corrective Action - CRA Regulation

Include under the above heading each violation of the regulation. If there are no violations, so state. Example format follows:

- o Delineation of Community. The institution has not used maps to portray community delineations.
- o Corrective Action. Management has stated that the institution will acquire the necessary maps on which it will portray the required delineations.
- o Community Reinvestment Act Statement.

12. For Agency use only, the examiner staff 3/ will assign a rating of 1 to 5 based on the institution's overall CRA performance. In connection with this rating, the examining staff 3/ will develop a narrative for Agency use specifically addressing the institution's efforts to help meet the credit needs of the low- and moderate-income neighborhoods in its local community.





BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

WASHINGTON, D. C. 20551

CA 84-5

DIVISION OF CONSUMER  
AND COMMUNITY AFFAIRS

August 16, 1984

TO OFFICERS IN CHARGE OF BANK EXAMINATIONS AND  
CONSUMER AFFAIRS SECTIONS AND TO COMMUNITY AFFAIRS OFFICERS

The purpose of this letter is to transmit supplemental examination instructions for the Community Reinvestment Act (CRA) portion of the Consumer Affairs Examination. These supplemental instructions are designed to provide examiners with additional guidance when evaluating a bank's record of opening or closing branch offices for purposes of the CRA assessment. We believe these instructions are needed since there is a growing trend among banks to close branch offices, particularly those located in inner-city communities, and subsequently to consolidate services outside of the communities that the closed branches had served. Such closings can have a cumulative negative effect, particularly if banks do not take steps to minimize the impact of the closings on the neighborhoods and if the neighborhoods affected are already in a less-than-stable or a declining position.

Branches often play an important role by providing banking services that are both convenient and necessary for the residents and businesses in a community. In recognition of this, examiners should be sure to consider the "bank's record of opening and closing offices and providing services at offices" as a factor in assessing a bank's performance under the CRA as contemplated by the present rating system.

The enclosed examination instructions should be used to supplement existing examination procedures, and are specifically aimed at Assessment Factor (g) of Regulation BB, The institution's record of opening and closing offices and providing services at offices, (Compliance Handbook, page II.1.51). Please distribute the enclosed materials to all consumer affairs examiners.

Sincerely,

Jerauld C. Kluckman  
Associate Director and  
Community Affairs Officer

Enclosure

Examination Instructions to Supplement Interagency  
Community Reinvestment Act Examination Procedures  
Assessment Factor (g) - Branch Closings

These instructions are intended to supplement existing examination procedures for the Community Reinvestment Act, specifically those relating to branch openings and closings (Assessment Factor (g) of Regulation BB).

Supplemental Examination Instructions

The purpose of these instructions is to provide examiners with points to consider when determining whether or not the bank's policies and actions in opening and closing branches are appropriate (Assessment factor (g)). Examiners should recognize that changes in the way banks deliver services are likely to occur because of cost concerns and technological advances. However, it is anticipated that most bank managers will endeavor to minimize the impact on its community of branch closings and, in particular, the impact on low- and moderate-income or minority areas in the bank's community. The closing of a branch is not necessarily the equivalent of a reduction or withdrawal of service from the community if a bank provides alternative means of meeting the needs of that community.

The examiner should review the bank's record of and future plans for opening and closing branches and determine what factors the bank's management uses to determine which branches to close, which to leave open, and where to open new branches. The bank's approach can be determined through interviews with bank personnel knowledgeable about the bank's policy on opening and closing branches. Information can also be obtained through reviews of minutes of board of directors meetings, other bank records, the Reserve Bank's files, and interviews with representatives of public organizations with a particular focus on low- and moderate-income and minority neighborhoods. Examiners should

also consider any information from interviews with community representatives about the attitudes of the community toward any actual or prospective branch closings.

The examiner's review of the bank's branch record should include at a minimum a review of the following items:

- Any actions the bank has taken to minimize the impact of branch closings by trying to continue to offer services by alternate means, such as providing a way for customers to continue to obtain credit, installing ATM's or night deposit facilities, or by promoting continued productive use of the branch building.
- Any attempts the bank has made to prevent closing any branches by adjusting hours, services, facilities, finding alternative sites suitable to community residents, or the like in an attempt to make the branch viable.
- The bank's written plan for opening or closing its branches, if applicable. (Also review minutes of board of directors meetings for discussion of same.)
- The bank's system to account for expenses, income and profitability of branches and the application of this system to branch closings. (Also review minutes of board of directors meetings for discussion of same.)
- Any studies that may have been done to determine whether other financial institutions adequately serve neighborhoods where bank branches are or will be

located or closed. (Also review minutes of board of directors meetings for discussion of same.)

- How and when customers are notified when a branch in their neighborhood will be closed.

After the review of each of the above is completed the examiner should weigh the information to determine whether the bank's branch opening and closing policies are reasonable or whether they unnecessarily have a disproportionate effect on low- and moderate-income neighborhoods. That determination should then be used to determine the component rating the bank will receive for Performance Category III, Geographic Distribution under the Uniform CRA Rating System. Examiners should place notes and other documentation supporting this portion of the CRA assessment in the examination workpaper package.

The CHAIRMAN. Thank you very much, Senator Graham.

I just have one more question I'm going to ask Mr. Wall.

Mr. Wall, yesterday Shanna Smith described three conditions the Bank Board set in approving a Toledo thrift application in 1979. The No. 1 condition was that it improve its marketing efforts. It apparently made a pitch that was directly aimed at the white community, up-scale community, the high-income community, and the Bank Board had indicated that they should have appealed across the board and make it clear that they were open and anxious to have Hispanics, blacks, and others use the bank facilities.

Second, that it meet with community groups; and third, to increase its loan portfolio to low-income neighborhoods.

What happened is that they failed to improve their marketing efforts or change them one bit. They did not meet with community groups. Their loan portfolio to low-income neighborhoods shrank. They didn't meet any of their commitments. Except for that, they were perfect.

Don't you think that the Bank Board should, No. 1, monitor performances closely and make it clear that if these conditions are not met it will take action of some kind?

Mr. WALL. Yes.

The CHAIRMAN. How do you explain this kind of a situation?

Mr. WALL. Did I hear you correctly you said that was a 1979 agreement?

The CHAIRMAN. I said approving a thrift application in 1979, yes.

Mr. WALL. My explanation would be market observation in terms of what happened to the thrift industry as well as lenders across the board during that period of time that has ensued since then. I'm not familiar with the market aspects of that particular market, whether it has been a dormant market or whether it's been an active market or whether there's been ups and downs, but certainly the institutions, whether they be thrift or bank, have gone through two cycles of difficulty in the intervening period. That might be some of the explanation.

The agency itself, as indicated in our response to your questions earlier and our letter back in January, as well as in my statement earlier, indicate that our industry as a whole, because of the interest rate spread problems of the 1978 to 1982 period and in the period of 1982 through today in terms of the asset deterioration problem in some institutions, we, of necessity, had to be focused on other problems.

The previous Board on the 1st of July delegated the examination and supervision responsibility to the twelve district banks so as to get those out from under the restrictions that had existed and been imposed by the appropriations and budget process when those functions were previously a Federal function.

So I think the change is underway by that delegation of the responsibility at the agency end, and it's a matter now of pursuing that. As I indicated, we have within ORPOS designated a specific compliance officer, Jerauld C. Kluckman, who has come from the Fed and whom we think is well prepared and experienced. He has jumped right into the harness as far as the examination and supervision enhancement that we have already initiated.



So a number of things are happening to try to be responsive to those market situations as well as the economic realities that have occurred since that 1979 date.

The CHAIRMAN. Thank you very much. I am deeply concerned with what I understand were the answers when I was absent to Senator Graham's question about ratings. I cannot for the life of me understand why we have this kind of graduate school ratings. When I went to graduate school everybody got an A. It was terrible, ridiculous. One guy got a B and almost killed himself.

When you have that kind of grade inflation, it just doesn't mean anything. Consider publicizing the grades, or at least make them available to the public. This encourages banks with a good record to boast about it.

Thank you very much, folks. I do hope we can do a better job on CRA. I think, unfortunately, we have not done very well so far.

Our next witnesses are Leland C. Brendsel, president of the Federal Home Mortgage Corporation; Dale P. Riordan, executive vice president, Administration and Corporate Relations, Federal National Mortgage Association; and J. Edward Carlton, Jr., secretary/treasurer, Mortgage Insurance Companies of America.

We will start with Mr. Carlton. I hope you can summarize your remarks in 5 minutes.

**STATEMENT OF J. EDWARD CARLTON, JR., SECRETARY/TREASURER OF THE MORTGAGE INSURANCE COMPANIES OF AMERICA**

Mr. CARLTON. Thank you, Mr. Chairman.

[The complete prepared statement of J. Edward Carlton, Jr., follows:]

Statement of J. Edward Carlton, Jr., Secretary/  
Treasurer of the Mortgage Insurance Companies of America  
Before the Senate Committee on Banking, Housing and Urban  
Affairs on the Community Reinvestment Act

Wednesday, March 23, 1988

Mr. Chairman and Members of the Committee:

I am J. Edward Carlton, Jr., President of Integon Mortgage Guaranty Corporation, headquartered in Winston-Salem, NC. I serve as Secretary/Treasurer of the Mortgage Insurance Companies of America (MICA)\*, the trade association representing the mortgage insurance industry.

I want to thank you Mr. Chairman for this opportunity to testify on how the mortgage insurance industry helps meet the mortgage credit needs of homebuyers and their communities. The nature and purpose of our business fulfills the spirit of the Community Reinvestment Act and we hope the information I provide today will be helpful in conducting your oversight responsibility. I also hope that my testimony will point out the need to examine whether the Federal Housing Administration (FHA) is fulfilling its responsibility in meeting the housing finance needs of lower income

\*MICA consists of the thirteen domestic private mortgage insurance companies which represent the active firms that help loan originators and investors make funds available to homebuyers by protecting these institutions from a major portion of the risk of default. The current MICA officers are President, William A. Simpson of Republic Mortgage Insurance Company, Winston-Salem, NC; and Vice President, William Levy of Mortgage Guaranty Insurance Corporation, Milwaukee, WI; Secretary/Treasurer, J. Edward Carlton, Jr., of Integon Mortgage Guaranty Insurance Corporation, Winston-Salem, NC. MICA also has member companies in Canada and Australia. At the end of 1986, the industry had over \$267 billion of insurance in force.

people. The FHA 203(b) program is the major tool the government has to provide assistance to the single family housing market today, so no examination of that market, especially the lower income segment, is complete without discussing FHA.

Let me begin by telling you how I plan to structure our testimony. First, I will discuss what the private mortgage insurance industry does and the role it plays in mortgage finance. Next I will discuss, the way the nature of risk has changed in mortgage finance and then go on to discuss what this has meant to the mortgage insurance industry. Finally, I will devote a substantial portion of my statement to discussing the need to retarget FHA to help expand homeownership to more lower income people.

The Role of Private Mortgage Insurance

Private mortgage insurance indemnifies mortgage lenders and investors for the direct and consequential losses incurred by reason of nonpayment of a mortgage loan. Mortgage insurance, therefore, enables lenders to accept mortgage applications which would otherwise be considered too risky, such as those with high loan-to-value ratios or those financed by some of today's modern mortgage instruments. More households with lower incomes and fewer assets are thus eligible for homeownership because of the mortgage insurance industry.

In addition, private mortgage insurance is instrumental in augmenting the flow of funds into home construction, which supports a considerable amount of employment. It also helps to enlarge the housing stock by adding new units to the supply. This in turn provides shelter for American families, improves the average quality of the housing supply, and helps remove substandard dwellings from the market.

Mortgage insurance also increases the fluidity of credit by shouldering much of the risk of home mortgage lending. A great deal of the capital flowing into housing comes from investors in the secondary mortgage market. These investors seek some certainty as to the quality of the mortgage investment. A guarantee from a mortgage insurer with broad underwriting experience and the financial structure to diversify risk concentration inherent in local markets can add uniformity or fungibility to home mortgages as investment instruments.

In general, then, the mortgage insurance industry fulfills many of the underlying goals of the Community Reinvestment Act. Mortgage insurance broadens homeownership, helps support the volume of new construction with its attendant economic benefits, expands the quality as well as the quantity of available housing, and fosters growth and stability in the mortgage market by accessing sources of funds that otherwise would not be available.

#### The Changed Nature of Risk in Mortgage Finance

New economic forces and dramatic changes in local market conditions have emerged in the past decade to change the basic

character and operating structure of the nation's lending and housing markets. Many facts point to changes in the nature of risk in mortgage lending. Delinquencies and foreclosures on home mortgage loans have increased significantly over the past 30 years, with the steepest surge occurring since 1979 (see Exhibit 1). In 1955, mortgages that were delinquent 90 days or more comprised less than .2 percent of total mortgages. Twenty-four years later (1979) this percentage had grown to about .5 percent. Between 1979 and 1985, on the other hand, delinquencies of 90 days or more doubled, and the number of loans in foreclosure tripled.

In addition, real estate owned on the books of the nations thrifts now exceeds \$20 billion, a level that is over 11 times higher than in 1979. Mortgage insurers also have experienced record losses, incurring over \$3 billion in direct losses between 1983 and 1986. The record of \$1.2 billion in direct losses incurred in 1986 was a five-fold increase over 1982 losses. FHA's Mutual Mortgage Insurance Fund also experienced an \$80 million underwriting loss in 1986 and this loss jumped to over \$700 million in 1987.

There were a variety of conflicting forces at work which caused this dramatic increase in risk. The mortgage lending environment of the 1970s was characterized by orderly lending markets served principally by heavily regulated local portfolio lenders and mortgage bankers. Almost without exception, these lenders confined originations to their local markets and offered their customers fixed-rate, fixed-payment mortgage loans at interest rates linked to stable passbook savings rates. Defaults that occurred under these conditions, even during periods of economic recession, produced

## EXHIBIT II

Illustration of the Cost to the Homeowner  
In a Declining Market

|                       |           |
|-----------------------|-----------|
| 1986 purchase price:  | \$100,000 |
| 1986 mortgage amount: | \$ 95,000 |

---

|                                              |                   |
|----------------------------------------------|-------------------|
| 1988 market price:                           | \$ 94,090         |
| Less brokerage fee and<br>closing costs (8%) | <u>\$ (7,527)</u> |
|                                              | \$ 86,563         |

|                                                   |                              |
|---------------------------------------------------|------------------------------|
| Less 1988 mortgage<br>amount (12% 30-year fixed): | <u><del>\$(94,267)</del></u> |
| Net sales proceeds:                               | <u><del>\$ (7,704)</del></u> |

|                          |           |
|--------------------------|-----------|
| Total Loss to Homeowner: | \$ 12,704 |
|--------------------------|-----------|

minimal losses were due to the relentless impact of inflationary forces on both borrower income and home prices.

In the 1980's, however, changes occurred and new risks were created. First of all, changes in world markets and prices began to effect major structural changes in many regional economies and alter the migration patterns of the nation's population. As a result, the vitality of many local housing markets became more dependant upon uncontrollable, and often unpredictable, global economic forces.

In addition, long-term mortgage rates began rising, severely reducing the number of borrowers who could qualify for a traditional fixed-rate loans and lenders responded with a proliferation of adjustable rate mortgages (ARMs). The financial services industry also went through some dramatic changes as they faced increasingly intense competition on the rates and terms of both deposits and mortgage loans. Deposits became more expensive and less stable and portfolio lenders experience intense competition from aggressive new entrants into the mortgage finance industry and large nationwide lending institutions.

Another significant event was the realization that we could no longer rely on the "inflation psychology" of the 1970's. The initial affordability of the new ARMs spurred the demand for housing and helped to pull the national economy out of its deep recession. As the economy expanded, however, the rapid appreciation in home prices and substantial borrower income growth that had been the norm in the 1970's failed to materialize in most markets.

These changes, since 1980, while positive in many respects, have definitely added to the complexity of today's lending environment. For those charged with the responsibility of managing mortgage risk today, that task is inherently more difficult.

#### The Effect of These Changes on Mortgage Insurers

While the mortgage industry is composed of thirteen different companies with different underwriting standards, some generalizations can be made about the effect of these economic changes on the individual insurers. Mortgage insurers have analyzed their recent claims experiences in an effort to reevaluate the way they manage risk and have developed underwriting standards commensurate with today's economic environment. The challenge to the mortgage insurance industry is to ensure that all those people with the desire to own their own home have the financial ability to keep that home.

Mortgage insurers are in a unique position from many other members of the mortgage finance industry to understand the effect of the new environment on homebuyers because we are on the same side of the mortgage transaction as the borrower. As discussed above, the primary role of our insurance coverage is to substitute for the borrower's equity and thereby, allow borrowers to obtain mortgages with low downpayments. Therefore, when a mortgage insurer underwrites a loan it not only has a profit motive to get the buyer into a home, but to ensure that the home remains affordable for that borrower far into the future. Our goal is to diminish the record number of claims the industry has paid and thereby, reduce the



record number of people who have gone through the anguish of foreclosure.

Mortgage insurers have identified three key factors which affect mortgage risk -- market related factors, borrower credit related factors, and lender related factors. Market related concerns arise because at any one time, certain areas of the country represent a greater mortgage insurance risk than others. Regional economic disruptions, such as depressed oil or agriculture prices, can produce localized stress within housing markets, even during periods of general economic expansion, and some areas that were once risky improve or vice versa. This volatility significantly increases the potential for catastrophic mortgage losses.

To manage market related risk and to protect borrowers, lenders, and insurers, mortgage insurers generally consider local market conditions when setting underwriting standards. For example, they will consider such factors as whether there is an oversupply of housing, whether the economy is dependent on one industry, or whether the market is experiencing a local downturn. Experience has taught mortgage insurers that it would be dangerous to originate and insure marginal loans during a local downturn or if there is an oversupply of housing in a market because these typically result in declining property values and the subsequent erosion of equity. For example, note that in the illustration provided in Exhibit II, the value of the house experiences only a three percent annual decline in market value over two years. If the borrower is forced into a selling situation at this point, for whatever reason, two scenarios present themselves: he can allow foreclosure and lose his \$5,000

equity, or he can sell the property at the current market price and lose \$12,704 (lost equity plus selling costs).

Market related issues, however, are not the only causes of delinquencies and foreclosures. In fact, Exhibit III shows that delinquencies of ninety days or more, still rose between 1980 and 1987 even if delinquencies in the economically troubled markets are eliminated. Borrower credit factors are equally as important in managing risk because a mortgage loan must have sufficient credit quality to withstand both economic fluctuations and individual financial reversals.

Mortgage insurers have identified a number of borrower credit factors that are vital to determining the level of risk in an individual loan and probably the most important of these is the amount of equity the borrower has in the property. Exhibit IV shows that, on privately insured loans originated between 1975 and 1985, claims paid by mortgage insurers on loans with a 95 percent loan-to-value ratio were about double that of claims paid on loans with a 90 percent loan-to-value ratio. Exhibit V\*, VI and VII provide claims data, based on borrower income and downpayment for FHA and privately insured loans for the years indicated. All three of these tables show that claims rates are determined more by the amount of downpayment than by borrower income.

The mortgage insurance industry, therefore, has come to realize that while the 95 percent loan plays an important part in mortgage

\*Exhibit V is from the study entitled "Comparison of Markets Served by Private Insurers and the Federal Housing Administration" (FHA Study) released by NICA in November 1987.

finance, these loans represent a higher exposure to risk and therefore require more conservative underwriting. Exhibit VIII shows the mortgage insurance industries involvement in 95 percent loans over the past 15 years. In the past two years our percentage of that business has declined to bring it more in line with what it historically had been. This decline also reflects the record defaults on these loans shown in Exhibit IV.

There are a variety of other borrower credit related factors that also are significant. For example the loan terms the borrower agrees to, should be ones that minimize equity erosion and "payment shock". We have already discussed what can happen when an economic downturn, an over supply of housing, or a low downpayment result in minimal or no equity in the property. The same is true if negative amortization reduces the borrower's equity.

"Payment shock" also can turn a sound mortgage program into a risky one, even under relatively stable interest rate conditions. For example, the effect of a 2 percent interest rate rise on a discounted one-year ARM with a 7.5 percent start rate, results in a 21 percent increase in the borrower's monthly payment. This does not mean, however, that ARMs that are intelligently designed and prudently underwritten cannot be a viable mortgage instrument.

Finally, lender-related factors are significant in identifying and managing risk. Mortgage insurers are now directing their lender-customers toward high-quality rather than simply high-volume loan originations. Mortgage insurers have found that many lenders were not concerned with the long-term viability of their own lending

operations and were not underwriting as though the loans were to become a part of their own portfolios in which they would retain an ownership interest. Too many loans lacked an accurate assessment of beginning equity, backed by a valid and professional appraisal. Too many loans involved fraud and misrepresentations in the primary underwriting. This type of practice is no longer acceptable to mortgage insurers and stress is being placed on quality control.

#### Expanding Homeownership

Housing policy which provides for a proper balance between the roles of the public and private sectors, brings the greatest efficiencies in the market place, resulting in homeownership opportunities for more people. Therefore, any discussion on ways to expand homeownership to more people at the margin, must include the FHA 203(b) program. This is particularly true now, since in the last two years FHA insured more loans than the private sector.

From its inception the goal of FHA was to meet the home financing needs of those who could not afford to meet the requirements of the private sector, by assuming the risk of default and by providing lenders with long term, level payment, self-amortizing mortgages. Eligible properties could not exceed \$16,000 in appraised value. A uniform annual premium of .5 percent of the outstanding principal balance was charged to all borrowers and a uniform loan interest rate was applicable. This uniformity ultimately benefited borrowers with very low downpayments or weaker

credit and the loan limits were expected to keep the program targeted to the lower end of the market.

Over time many changes have occurred in the regulations of the FHA program. For example, the maximum loan limits have been increased again and again, the administered interest rate was abandoned, a single premium paid at settlement was adopted, and direct endorsement was permitted. These and other changes have helped the lender effectively reach a larger market, but have been detrimental to preserving FHA's ultimate mission.

Exhibit IX\* provides FHA originations by borrower income from 1981 to 1986 and Exhibit X provides FHA originations by loan amount for the same years. Together they show that FHA is no longer serving the market Congress intended it to, but has steadily increased its share in the upper end while its service to lower income people declines. Note that in 1986, 54 percent of FHA loans were to borrowers receiving loans over \$60,000, while 42 percent of the borrowers had incomes over \$40,000. In 1986, \$40,000 was approximately 140 percent of the U.S. median house hold income.

Exhibit XI and XII show similar data for privately insured loans. What is most striking about this table when compared to the FHA data is that FHA and private insurers have very similar records in serving the lower end of the market. This is particularly astounding when one notes that mortgage insurers have no loan limits and have no public policy mandate to serve a certain market

\*Exhibits IX through XIV were developed from data in the FHA Study.

segment. Note that Exhibits XIII and XIV from the FHA Study\*, show that these national trends hold true in 13 economically diverse metropolitan statistical areas (MSAs).

This profile of the market served by FHA is understandable in light of the basic mortgage banking principals under which FHA is expected to provide mortgage credit. Almost 100 percent of FHA insured loans are sold to the Government National Mortgage Association (GNMA). The profit level of loans sold in the secondary market correlate directly to loan size. Both origination and servicing fees are based on a percentage of the loan amount and when servicing portfolios are bought and sold, higher prices are paid for larger loans because they offer greater profits. Processing of higher income borrowers also is generally easier and there is less probability for payment disruption. As a consequence, a lender has incentives to originate FHA loans that serve the higher versus lower income borrowers.

The low income homebuyer, therefore, often finds that no FHA loans are available or the lender's pricing of the FHA loan is tiered. With "tiered pricing", lenders charge borrowers receiving these small loans a higher interest rate or more points than someone obtaining a larger loan. This acts to offset the lost profits on the low principled loan.

Lenders, therefore, play the key role in ensuring that the home financing needs of lower income people are being met, and this is true whether the loan is FHA or privately insured. The lender, not

\*This study was intended to compare the markets served by FHA and the private sector so the privately insured loans only include those within FHA limits.

the insurer has direct contact with the borrower and is in the best position to evaluate the overall credit worthiness of the transaction. Both private and public insurance maintain fairly flexible standards and can only insure the loans sent to them by the lender.

Other important players in the housing field also have been forced by their business motivations to contribute to the present inequalities in the system. New homes have steadily increased in price and home builders who want to ensure that they will be able to sell their inventory of homes generally have pushed FHA to the higher end of the market. Likewise real estate agents, whose profits also depend on the certainty that the mortgage loan will be approved, have supported continued expansion of FHA's program to a broader and more active market. Because a real estate agent's income, like the lender's, is based on a percentage of the price of the home, the business incentive can exist to reduce uncertainty and point homebuyers in the direction of larger FHA insured financing.

There also are many attractive consumer benefits that act as an incentive for higher income borrowers to seek FHA loans over conventional financing. These include the following: nationwide underwriting requirements which make the underwriting requirements less restrictive than conventional standards in many markets; lower downpayment requirements; access to the GNM which for some borrowers can lower costs than are available on conventional loans; the ability to finance closing costs; a uniform insurance premium that is not based on a reasonable risk analysis; the ability to finance the premium; and importantly, the ability for a subsequent borrower to assume the loan.

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MICA believes that these trends with FHA will continue unless Congress acts to retarget it. This is particularly true in view of the fact that the FHA loan limits were recently raised to \$101,250 in high cost areas. It has been consistently shown regarding FHA loan limits that, in the words of a former House Housing Subcommittee Chairman, the ceiling becomes the floor.

MICA believes FHA should be targeted so that its benefits are directed to lower income people. In addition it is imperative that incentives be built into the system to make it attractive to lenders to make these low balanced loans. FHA loans to the nontargeted groups, on the other hand, should operate on a market basis, thereby enabling conventional loans to compete with FHA more easily.

If FHA is more active in providing mortgage credit to those at the margin of homeownership, it would not only simply provide more credit to those buyers but it would act as a stabilizer for that low income market. Fluidity takes much of the risk out of a market and makes it more attractive for the private sector to be more active in it. In addition, if FHA is targeted to the lower income market, the private sector could regain some of the volume it has lost to FHA in the last two years. This would enable an insurer to better spread its risk and, therefore take on more risky loans at the lower end. As a result the overall availability of mortgage credit from both the private and public sector will increase, expanding the ability for more low income people to own their own home.

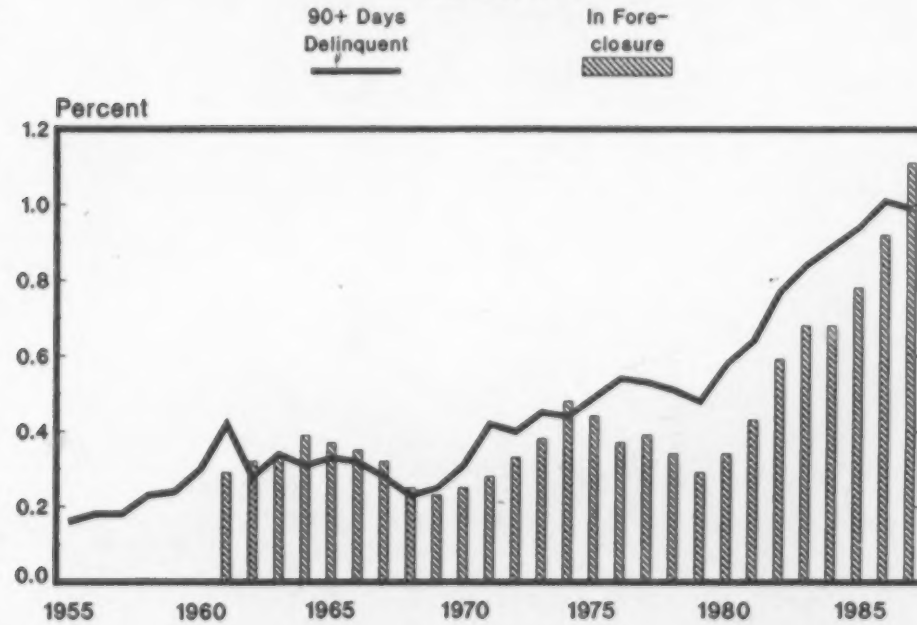
Thank you for the opportunity to testify. Please let me know if you need further information.

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EXHIBIT I

DELINQUENCY AND FORECLOSURE RATES  
ALL LOANS



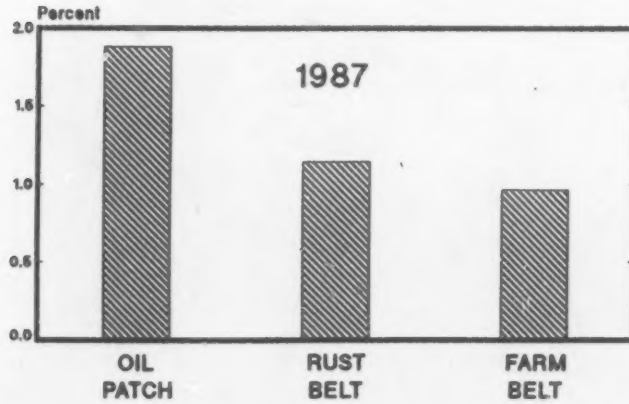
SOURCE: MORTGAGE BANKERS ASSOCIATION



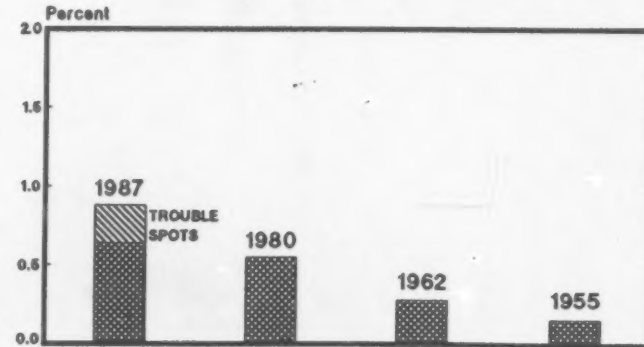
EXHIBIT III

DELINQUENCY RATES  
LOANS 90+ DAYS DELINQUENT

TROUBLE SPOT DELINQUENCY RATES



TOTAL U.S. DELINQUENCY RATES

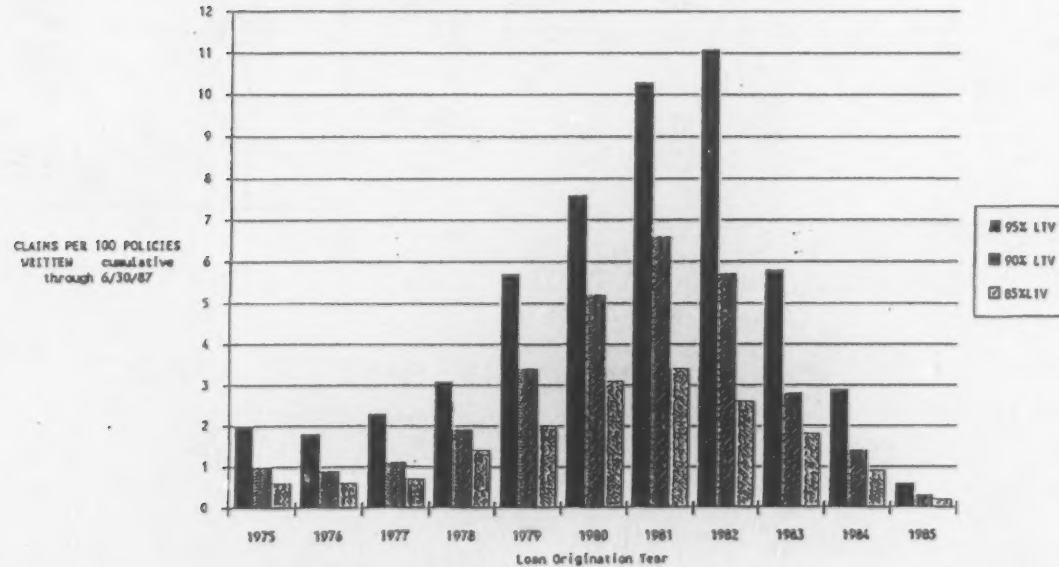


SOURCE MORTGAGE BANKERS ASSOCIATION

# EXHIBIT IV

HIGHER LOAN-TO-VALUE RATIOS/LOWER EQUITY CAUSES HIGHER FORECLOSURE/CLAIM RATES

Claims Incidence for 85%, 90% and 95% Ratio Loans for Origination Years 1975 to 1985  
Cumulative Experience through June 30, 1987\*



Source: Temple, Barker and Sloane, Inc.

\* Includes conventional insured loans only.

# EXHIBIT V

FHA Three-Year Claim Rates for 1982 and 1983 Endorsements<sup>1</sup>

| Borrower Income |                  |
|-----------------|------------------|
| Under \$40,000  | \$40,000 or More |
| 5.8%            | 4.0%             |

| Downpayment          |                       |
|----------------------|-----------------------|
| Less Than 10 Percent | 10 Percent or Greater |
| 7.0%                 | 1.4%                  |

| Borrower Income | Downpayment          |                       |
|-----------------|----------------------|-----------------------|
|                 | Less Than 10 Percent | 10 Percent or Greater |
|                 | Less Than \$40,000   | 7.5%                  |
|                 | \$40,000 or More     | 1.3%                  |
|                 |                      | 5.4%                  |
|                 |                      | 1.6%                  |

Source: FHA

<sup>1</sup>1983 rates include claims through September 1986.

# EXHIBIT VI

## Private Mortgage Insurance Industry Two-Year Claim Rates for 1984 and 1985 Originations

| Borrower Income |                  |
|-----------------|------------------|
| Under \$40,000  | \$40,000 or More |
| 1.3%            | 1.2%             |

| Downpayment          |                       |
|----------------------|-----------------------|
| Less Than 10 Percent | 10 Percent or Greater |
| 1.6%                 | 0.8%                  |

|                 | Downpayment          |                       |
|-----------------|----------------------|-----------------------|
|                 | Less Than 10 Percent | 10 Percent or Greater |
| Borrower Income | Less Than \$40,000   | 1.7%                  |
|                 | \$40,000 or More     | 0.7%                  |
|                 | Less Than \$40,000   | 1.6%                  |
|                 | \$40,000 or More     | 0.8%                  |

# EXHIBIT VII

## Private Mortgage Insurance Industry Three-Year Claim Rates for 1984 Originations

| Borrower Income |                  |
|-----------------|------------------|
| Under \$40,000  | \$40,000 or More |
| 3.3%            | 3.3%             |

| Downpayment          |                       |
|----------------------|-----------------------|
| Less Than 10 Percent | 10 Percent or Greater |
| 4.4%                 | 2.0%                  |

| Borrower Income | Downpayment          |                       |
|-----------------|----------------------|-----------------------|
|                 | Less Than 10 Percent | 10 Percent or Greater |
|                 | Less Than \$40,000   | \$40,000 or More      |
|                 | 4.4%                 | 1.7%                  |
|                 | 4.4%                 | 2.3%                  |

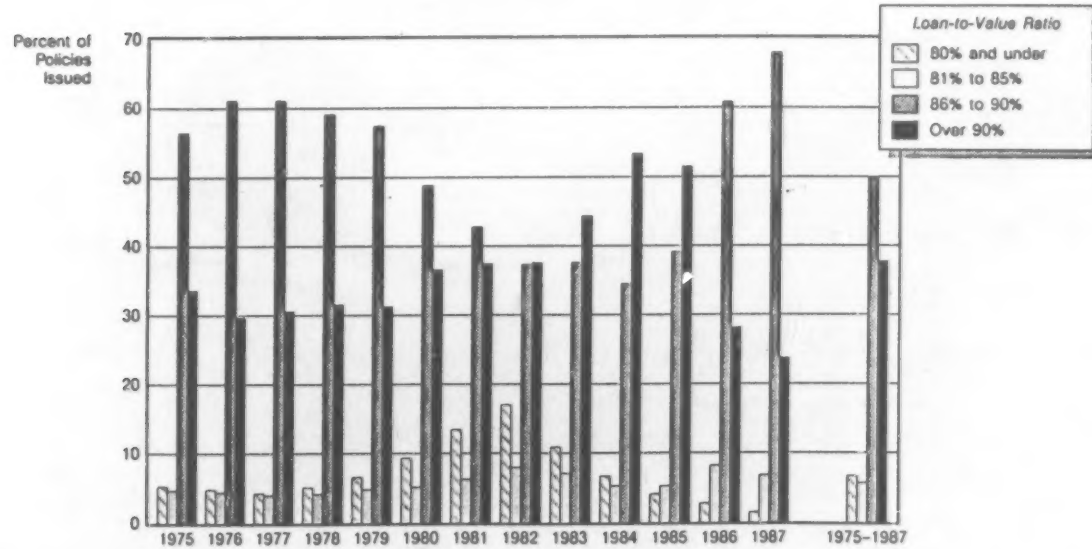


# EXHIBIT VIII

## Distribution of Policies Issued by Loan-to-Value Ratio

### Private Mortgage Insurance Industry

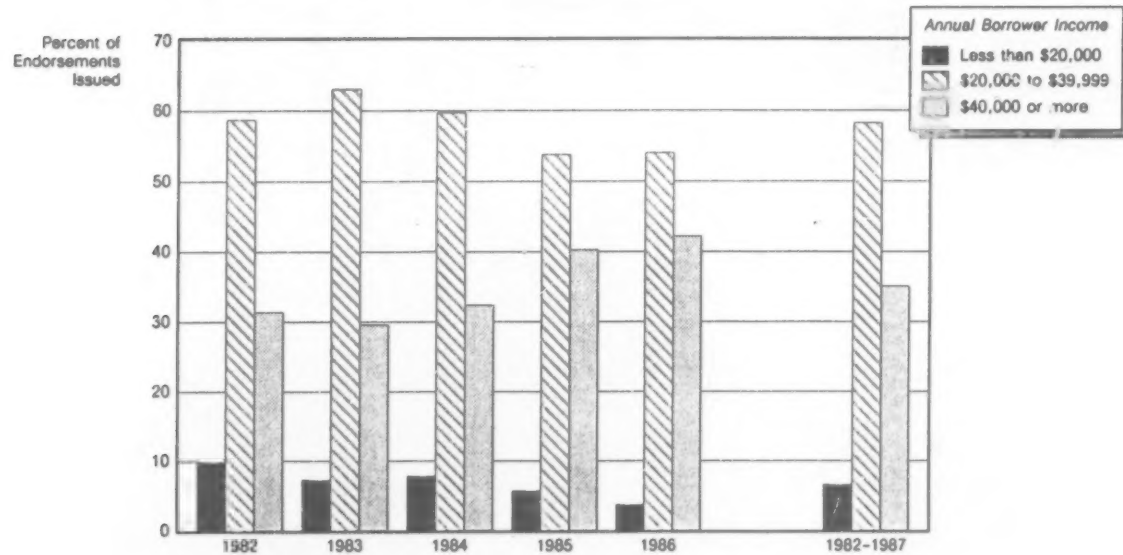
1975-87



Prepared by Temple, Barker & Sloane, Inc.

EXHIBIT IX

Distribution of Endorsements by Borrower Income  
Federal Housing Administration  
1982-86



Prepared by Temple, Barker & Sloane, Inc.

The CHAIRMAN. Thank you very much, Mr. Carlton, for a fine statement.

Mr. Riordan.

**STATEMENT OF DALE P. RIORDAN, EXECUTIVE VICE PRESIDENT, ADMINISTRATION AND CORPORATE RELATIONS, FANNIE MAE**

Mr. RIORDAN. Thank you, Mr. Chairman.

My name is Dale Riordan and I'm the executive vice president of Fannie Mae, and I appreciate the opportunity to present our views on CRA.

I'd like to discuss briefly three things today: what role Fannie Mae has in supporting CRA; what our experience has been recently in depressed markets like Texas, as you've asked us to comment on; and how we think that CRA can be improved.

With respect to our underwriting guidelines, we believe that our standard underwriting guidelines support CRA as do our special programs targeted to low- and moderate-income households.

With respect to the former, our involvement with CRA goes back to 1978 when, at your encouragement, Mr. Chairman, we met with community groups and agreed to make a number of changes in our underwriting guidelines to support CRA. Specifically, we incorporated antiredlining language, encouraged lenders to sell us loans in older neighborhoods, and addressed the special concerns of lower-income borrowers in affirmative language.

Beginning in 1981 we made some very significant changes in the way that we did business to respond to the severe losses that we were incurring. These not only included business changes such as shifting more to a mortgage-backed securities program and better matching our assets and liabilities, but also streamlining and simplifying our guidelines. In essence, we delegated most of that responsibility to our lenders with a warranty back to us.

**NEW GUIDELINES**

In 1985, Fannie Mae, among many other financial institutions, began to experience significant difficulties on delinquencies and we took a look at our experience and our credit and appraisal guidelines particularly; as a result we tightened up the income and credit requirements for loans that had low borrower equity. We also specifically ceased buying particular kinds of ARM's, those for instance without any payment caps or any interest rate caps and, we reduced some other high risk factors that we believed were a problem in connection with low equity loans.

Regrettably, as we rewrote our guidelines substantially after 1981 to turn more to a warehousing type as opposed to more retail type business directly with lenders, we didn't include all the CRA-related changes that we had made earlier. We had not intended to send a different message in this regard. We simply didn't focus on the effect of the massive overhaul of our guidelines after 1981. And while we don't think that there was any deleterious effect from this, we certainly agree that we made a mistake and we are now in the process of correcting it.

We are pleased that both NPA and ACORN have brought these concerns to us, and in fact over the last several months we've made

a number of changes at their request. These include reintroducing the specific antiredlining language that was in our guidelines, eliminating restrictions relating to certain zoning restrictions on nonconforming use, emphasizing our flexibility on past credit problems, and so forth. And we have also included affirmative rather than neutral language encouraging our lenders to sell us mortgages to assist neighborhood revitalization efforts.

Now a few weeks ago a couple of other concerns were brought to us by NPA. We've resolved about half of them in the matter of about 2 weeks and we think we can resolve the rest of them in another 2 weeks. So I think we are well on our way to fixing those guidelines and getting them back to where they should be.

With respect to our specific efforts, last year Fannie Mae established an Office of Low- and Moderate-Income Housing and we are trying to funnel all of our special low-income efforts through that particular office. We have four ways in which we do that, Mr. Chairman.

The first is through our community lending programs where in effect we deal with local lenders and city and State governments and we find opportunities to provide homeownership for low- and moderate-income families that often involve very small downpayments on the order of \$500 to \$1,000. Our most recent effort that we've announced is in the State of Florida.

The second is that more and more lenders are coming to us eager to expand their community lending programs. The best example, or at least the most local example of that, is here in the District called the Home Sight Program where we agreed last year to buy up to \$15 million of loans on rehabilitated properties that will represent approximately 300 home purchases.

Third, we've worked closely with State and local housing finance agencies with tax-exempt revenue bonds. Fourth, most important as the centerpiece of what we're doing, is the low-income housing tax credit which was established by the Congress in 1986 to replace some of the other incentives.

We have committed to invest over \$40 million in equity funds—those are funds completely at risk to us—in housing that will qualify for the low-income housing tax credit and we expect that to increase substantially during 1988.

#### FORECLOSURES

On the second point, Mr. Chairman, you asked in your letter inviting us to testify whether the high foreclosure rates in States like Texas would preclude secondary market activity to low income borrowers. The answer is definitely no. Fannie Mae's business in these States, we think, demonstrates forcefully one of the primary benefits we provide, and that is our consistent support of all areas of the country, no matter what the economic circumstances are.

And in the last 2 years alone, which were very tough for Texas, Fannie Mae bought \$7 billion worth of loans which represent over 100,000 individual mortgages. Besides Texas we also have continued to lend in fairly large volumes in the other States like Colorado and Louisiana. In addition, because of the specific delinquency problems in Texas, Oklahoma, Louisiana and Colorado, we have

contributed \$50,000 to help finance a couple of new franchises of an effort that's called the Home Ownership Protective Effort, or HOPE. Essentially that is counseling for home owners whose mortgages are delinquent due to borrowers being unemployed or underemployed.

Finally, we've established a broad loan modification program for families in those States because we are more interested in helping those people stay in their homes, and because in every foreclosure we lose a great deal of money.

With respect to what we think we can do to improve CRA, there are two contributions which mirror the first part of my statement. First is continuing to place a high priority on our standard underwriting guidelines; and second is to continue to put the kind of effort behind this new Office of Low- and Moderate-Income Housing that I described, pursuing those opportunities aggressively.

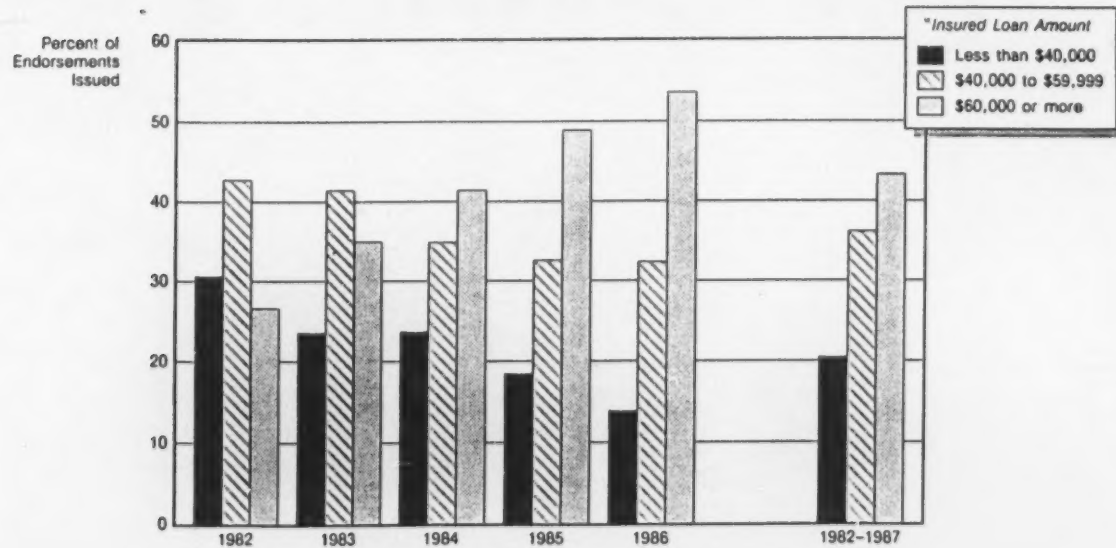
With respect to what we think will be recommended shortly, the National Housing Task Force, which I'm sure you're aware of, Mr. Chairman, that was put together under the aegis of Senators Cranston and D'Amato, will be making its report next Monday and there will be specific recommendations in that.

[The complete prepared statement of Dale P. Riordan follows:]



**EXHIBIT X**

**Distribution of Endorsements by Insured Loan Amount**  
*Federal Housing Administration*  
1982-86



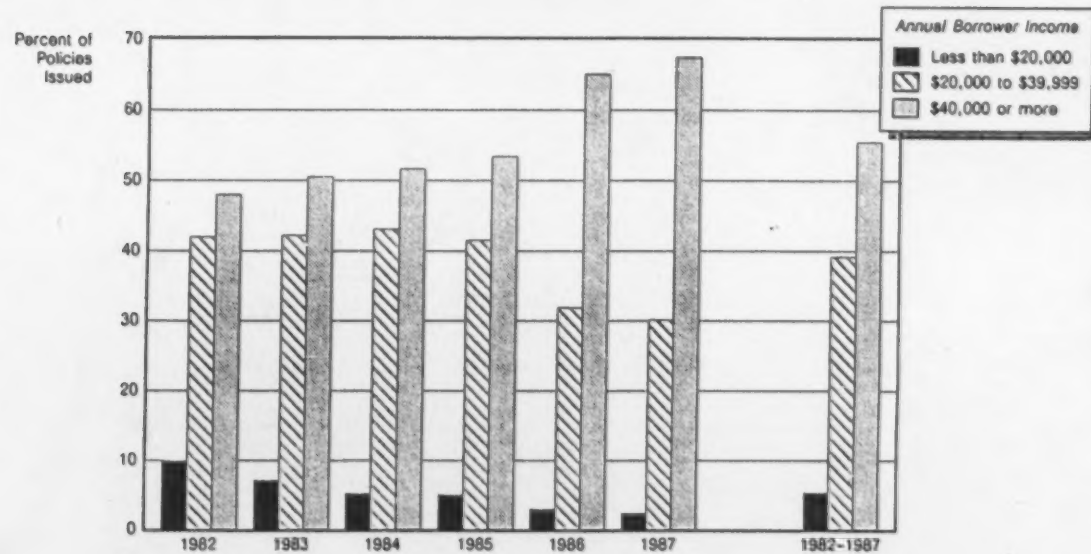
Prepared by Temple, Barker & Sloane, Inc.

# EXHIBIT XI

## Distribution of Policies Issued by Borrower Income

### Private Mortgage Insurance Industry

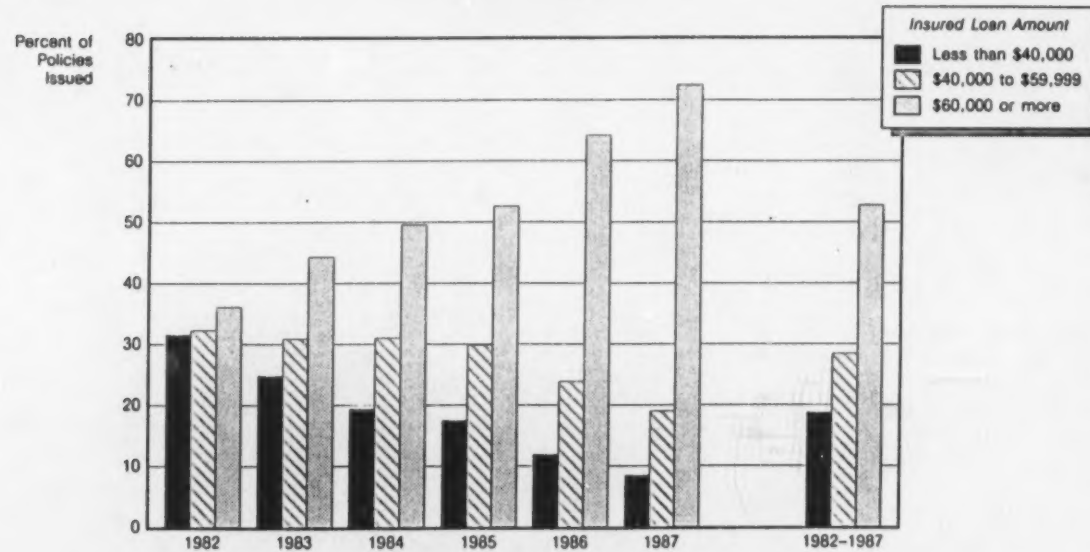
1982-87



Prepared by Temple, Barker & Sloane, Inc.

EXHIBIT XII

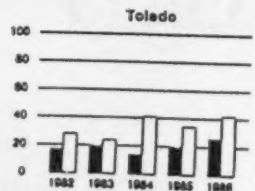
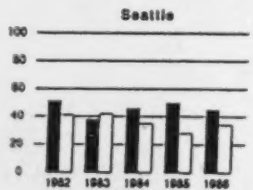
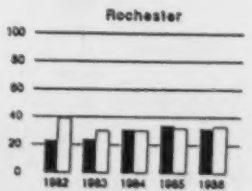
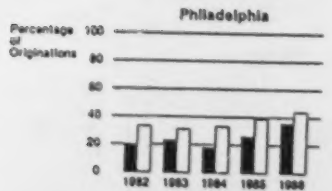
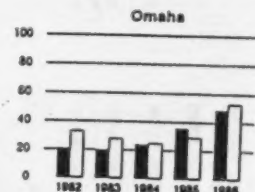
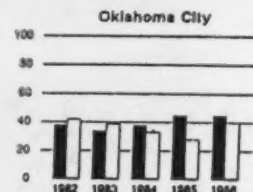
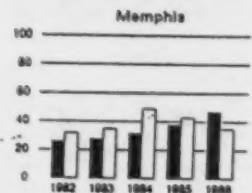
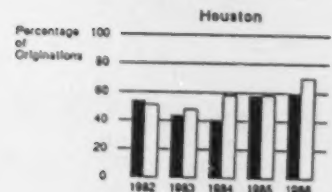
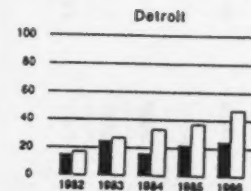
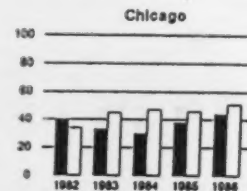
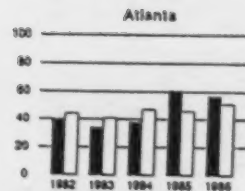
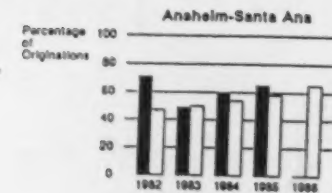
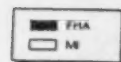
Distribution of Policies Issued by Insured Loan Amount  
Private Mortgage Insurance Industry  
1982-87



Prepared by Temple, Barker & Sloane, Inc.

# EXHIBIT XIII

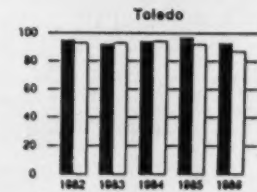
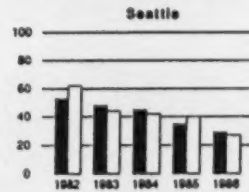
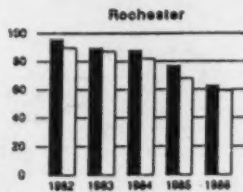
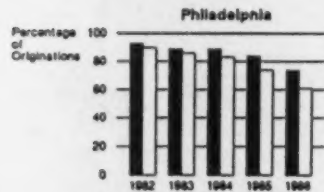
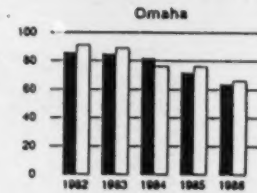
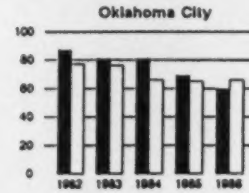
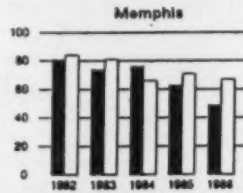
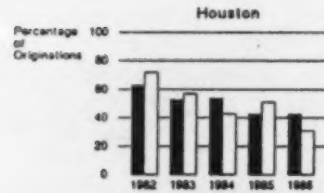
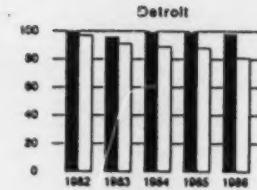
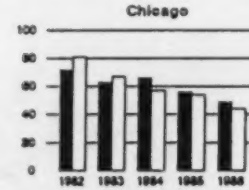
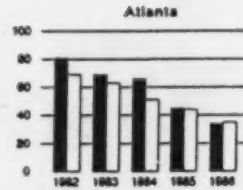
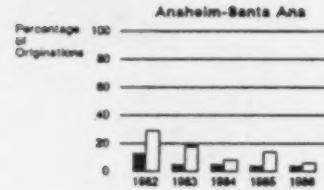
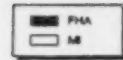
FHA and MI Originations to Borrowers  
with Incomes Over \$40,000



Note: MI data are restricted to loans within FHA limits.  
Source: FHA and MICA.

## EXHIBIT XIV

### FHA and MI Loans Under \$60,000



Note: MI data are restricted to loans within FHA limits.  
 Source: FHA and MICA.



Statement of  
DALE P. RIORDAN  
EXECUTIVE VICE PRESIDENT  
ADMINISTRATION AND CORPORATE RELATIONS  
FANNIE MAE  
Before the  
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS  
of the  
UNITED STATES SENATE  
MARCH 23, 1988

Mr. Chairman and members of the Committee:

My name is Dale Riordan, Executive Vice President for Administration and Corporate Relations at Fannie Mae. Fannie Mae is a publicly owned, privately managed corporation with a federal charter. We are regulated by the Department of Housing and Urban Development (HUD), and the timing of our debt issues is coordinated by the Treasury. Our congressional charter limits us exclusively to making a secondary market in home mortgages -- both single-family and multifamily. We purchase mortgages from over 3,500 lenders throughout the country, replenishing them with funds to lend to additional borrowers.

Fannie Mae is the nation's largest investor in mortgages, with \$93.8 billion outstanding at the end of 1987; we also issue and guarantee mortgage-backed securities (MBS), and there were \$140 billion outstanding MBS at the end of last year. Together, Fannie Mae's portfolio purchases and MBS finance about one out of every eight mortgages in the United States. Last year, our business volume exceeded \$80 billion.

I appreciate this opportunity to discuss Fannie Mae's views on the Community Reinvestment Act (CRA). We fully support its goals. Through our operations in the secondary mortgage market, we believe we will continue to play an important role in helping primary lenders meet the financing needs of their communities, including low- and moderate-income neighborhoods.

Fannie Mae helps make housing more accessible and affordable for all Americans -- particularly low-, moderate-, and middle-income households. The average size of the mortgage we now hold in our portfolio is \$46,000. Between January 1986 and June 1987, we purchased nearly 2 million mortgages, and the average size of those mortgages was about \$64,000. During the first half of 1987, nearly 35 percent of the loans we purchased carried mortgage balances of \$40,000 or less, which a family with an annual income of approximately \$17,000 could afford (compared to a median family income of \$30,650).

In addition, during the past year, we expanded appreciably activities designed to broaden housing opportunities for lower-income families and to help revitalize older neighborhoods. The latter has been accomplished primarily through community lending programs, equity investment in low-income housing projects eligible for low-income housing tax credits, and public finance programs. While we are proud of our record, we recognize the need to do more. We are working diligently to build on what we've already accomplished.

My remarks today focus on four areas:

- o First, the general principles that guide Fannie Mae's underwriting practices.

- o Second, how Fannie Mae views its role in supporting the objectives of CRA, and how we have addressed this issue in our underwriting guidelines and our business.
- o Third, the role Fannie Mae has played in depressed areas such as Texas.
- o Fourth, from a secondary market perspective, the changes and improvements that we think can be made to assure that the mortgage credit needs of the nation's communities are met.

#### GENERAL PRINCIPLES UNDERLYING FANNIE MAE'S UNDERWRITING

Before reviewing Fannie Mae's specific underwriting guidelines related to CRA, I would like to define the basic principles that guide our underwriting, which play a critical role today. In this decade, Fannie Mae, Freddie Mac and other private players have greatly expanded the sources of funds for home mortgages. By linking the capital and mortgage markets, the secondary market has provided millions of families a reliable supply of credit at lower cost.

Because we are one of the largest suppliers of mortgage credit, our loan guidelines are viewed by mortgage lenders as an industry standard. This provides strong incentives for lenders to conform to -- or closely follow -- our underwriting guidelines, even though they may be originating loans for their own portfolios. By following our guidelines, their loans are automatically more liquid, hence more saleable.

Our underwriting guidelines strike a delicate balance between providing affordable funds to home buyers and managing credit risk. We want to cast the widest possible net over the universe of credit worthy borrowers while maintaining standards that assure investor confidence in our mortgages and in the company itself. If we don't strike the right balance, we will have defeated our purpose by compromising our future ability to help borrowers. If investors lose confidence, they will commit less money and demand higher yields to compensate them for higher risk. Home buyers will foot the bill in the form of higher interest rates. Also, we do no favor to home buyers -- especially low-, moderate- and middle-income families -- if we saddle them with obligations they cannot carry.

We also draft our guidelines to ensure that they reflect not only sound underwriting practices, but the legislative concerns affecting the primary mortgage lender. We continually review and monitor our guidelines to ensure that they fully support local, state and federal laws relating to fair housing, equal credit opportunity, truth in lending and wrongful discrimination in residential lending.

#### FANNIE MAE'S ROLE IN SUPPORTING CRA OBJECTIVES

Fannie Mae's standard underwriting guidelines help support the objectives of CRA, as do our special programs targeted to low- and moderate-income households.

##### A. Underwriting Guidelines

Our involvement with this issue has a long history. In the 1970s, in response to the concerns that prompted CRA, fair housing laws and equal housing opportunity, Fannie Mae met with a number of community groups to strengthen our underwriting guidelines to complement the goals of these laws. The specific requirements of CRA -- mandating consideration of regulated lenders' records in meeting the credit needs of their entire communities -- arose from concerns that the practice of "redlining" older and lower-income urban neighborhoods was accelerating disinvestment and decay in these areas.

Among other things, the changes we adopted at that time: (1) defined redlining, expressly cautioned lenders that our guidelines should not be interpreted as permitting such a practice, and stated that race was not a predictive factor for risk assessment; (2) encouraged lenders to sell us loans in older neighborhoods; and, (3) addressed the special concerns of lower-income borrowers in affirmative language by spelling out acceptable variations from general credit guidelines. We believe this was a responsive and promising start.

Beginning in 1981, we made significant changes in the way we did business to respond to the threat of severe losses. In order to survive as a company, we developed more efficient methods of doing business. These included shifting from buying loans only for portfolio to issuing MBS, and retooling the company to adapt to market volatility. Rather than underwriting every loan purchased, we delegated underwriting and approval of our loan purchases to the originating lender. We required lenders to make a contractual warranty to us, acknowledging compliance with our guidelines and with all applicable local and federal laws governing their mortgage lending. We added lender monitoring programs and post-purchase loan sampling. We streamlined and simplified our guidelines to make the change workable for our lenders. We are happy to say this survival strategy worked, as we are now in very sound financial shape.

In 1985, Fannie Mae -- among many other financial institutions -- experienced mounting delinquencies. We took a hard look at our credit and appraisal guidelines. As a result, we tightened the income and credit requirements for loans with low borrower equity. We also discovered that the "payment shock" potential of uncapped adjustable-rate mortgages (ARMs) was a major cause of delinquency and default, and we discontinued purchasing ARMs without rate caps and ARMs with graduated payment features.

Finally, we reduced other high risk factors in connection with low-equity loans by limiting the use of "buydowns," strengthening the rules on down payments by co-borrowers, and requiring a minimum five percent down payment in addition to funds received as a gift toward the purchase of a home.

Regrettably, as we rewrote our guidelines to incorporate our new business practices, we did not include all the CRA-related changes we had made earlier. We did not intend to send a different message; we simply did not focus on this effect of the massive overhaul of our guidelines after 1981. Unfortunately, the changes as a whole did not provide lenders with guidance that was as clear and supportive as we believe it should have been. We made a mistake, and we have now corrected it.

We are pleased that National People's Action (NPA) brought this to our attention last year. We have discussed this issue at some length with them and with the Association of Community Organizations for Reform Now (ACORN). Before this dialogue began, we had already prepared new guides that addressed many of the issues raised by these groups. However, we delayed publishing them until January of this year in order to incorporate additional specific suggestions.

The recent changes in our guides made several improvements. We reintroduced specific anti-redlining language in our neighborhood analysis guidelines. We also eliminated restrictions related to zoning standards for non-conforming use; emphasized our flexibility related to past credit problems, i.e., a previous bankruptcy, and to the use of part-time income in qualifying lower-income applicants; and made other deletions and additions that emphasized flexibility on issues such as loans with maximum financing, down payment requirements, and evaluation procedures for neighborhood conformity that ensure a non-discriminatory interpretation. Finally, we included affirmative (rather than neutral) language encouraging lenders to sell us mortgages to assist neighborhood revitalization efforts, and encouraged working with our new Office of Low- and Moderate-Income Housing.

After agreeing to changes with NPA in October, we expressed an interest in continuing discussions on certain issues. We believe we are making good progress toward resolving their concerns. We have exchanged correspondence with them, and we hope to resolve these matters in a couple of weeks.

#### B. Fannie Mae's Other Initiatives to Support Neighborhood Revitalization and Low- and Moderate-Income Housing Needs

Despite long-term gains that we have made as a nation in housing our citizens, many people remain ill-housed or are forced to pay unacceptably large amounts of their income for shelter. Recent trends have highlighted this squeeze. During the last decade, for example, increases in housing costs for renters and aspiring homeowners have far outpaced income growth. Between 1970 and 1983, while median income of renters doubled, the median rent nearly tripled. From 1970 to 1986, the median price of an existing single-family home rose 249 percent -- from \$23,000 to \$80,000 -- while the national median income rose by 183 percent, from \$9,876 to \$27,893.

As a result of these trends, the nation's low- and moderate-income households face real problems in finding affordable, decent housing and several studies (by the Joint Center for Housing Studies, the National Association of Realtors, and the U.S. League of Savings Institutions) have documented this. Low-income households face a shrinking supply of affordable rental housing, even as the need for such housing expands. The shift in federal housing support over the last decade, to housing vouchers rather than project-based subsidies, has made the situation worse.

The disparity between growth in income and housing costs also has made homeownership more difficult to achieve, especially for low- and moderate-income families. In 1980, homeownership began declining for the first time in 50 years, falling from 65.6 percent to 63.8 percent between 1980 and 1986. This drop hit hardest at younger households headed by people in the 25-34 age bracket, with their homeownership rate plummeting to less than 46 percent in 1986 from 55 percent in 1980.

These conditions have fostered an increasing dependence on housing initiatives at the state and local levels, and on partnerships between the public and private sectors, to address the housing needs of low- and moderate-income families. City-based, public-private partnerships have sprung up across the country -- including Pittsburgh, New York, Chicago, San Francisco, Oakland, and Boston. The Enterprise Foundation and the Local Initiatives Support Corporation (LISC) were established to provide seed money and technical assistance to community nonprofit developers.

Fannie Mae is proud of its role in this innovative search for solutions. In 1987, we created an Office of Low- and Moderate-Income Housing to help focus and expand our efforts to increase housing opportunities for our nation's neediest citizens. Last year, we invested more than \$1.5 billion, and committed to invest additional amounts, that will help house nearly 35,000 low- and moderate-income families. I have provided each member of the Committee with a copy of a report describing

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our 1987 low- and moderate-income housing initiatives in more detail.

Our special efforts take several forms. For example, we are expanding aggressively our community lender programs, in which we provide primary mortgage financing, associated with subsidized secondary financing provided by a state, city or nonprofit organization. Through these programs, low- and moderate-income home buyers, who would otherwise be priced out of the market, can obtain mortgages. We emphasize the rehabilitation of vacant and abandoned houses (often VA and FHA foreclosures) in targeted neighborhoods, and we try to involve local community development corporations (CDCs). We have committed nearly \$100 million to these programs since the beginning of 1987.

More and more lenders are coming to us, eager to begin community lending programs in their cities, and we are providing them with technical assistance and support, as well as buying their loans. Fannie Mae currently has a dozen such programs under way in various cities. Through the D.C. "Homesight" program, for example, Fannie Mae will purchase up to \$15 million in first mortgages for roughly 300 home purchases of rehabilitated properties identified and renovated by local CDCs.

We also have worked with state and local housing finance agencies to reduce the cost of mortgages financed with tax-exempt bonds. This has included private placement purchases of tax-exempt mortgage revenue bonds, which reduces the agencies' issuing costs, thus allowing them to pass along the savings to first-time home buyers.

The low-income housing tax credit is a central part of our housing affordability efforts. Fannie Mae believes strongly in the value of the tax credit, and we are committed to encouraging other corporations to make use of it. In 1987, we will invest more than \$40 million in equity funds in housing that will qualify for tax credits, and we expect that figure to grow substantially during 1988.

Our investments reflect the range of housing to which the credit can be applied. In one effort, we will invest \$38 million in New York City to help finance the rehabilitation of up to 1,000 units of abandoned housing in target neighborhoods. Fannie Mae works with the Enterprise Foundation, which is assisting New York's community groups to identify appropriate structures and help them structure the transactions. The city of New York is making available city-owned properties at nominal cost, and both the city and the state are providing mortgage financing on concessionary terms. We already have identified two projects for financing, and we are eager to finance others.

In another effort in Washington, D.C., we have been working for the past year with the nonprofit organization known as So Others Might Eat (SOME), the D.C. Department of Housing and Community

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Development, the Enterprise Social Investment Corporation, the development firm of Mulligan & Griffin, Maryland National Bank, and Citicorp. Our combined efforts will produce Washington's first permanent housing for the homeless: a 100-unit single-room occupancy (SRO) project that will serve as a model for future efforts. We expect to make an equity investment in this SRO, and we are proud to be part of such a first-rate public/private partnership that can make a truly vital and innovative contribution to the homeless of our hometown.

Another example of the value of the tax credit is a transaction we recently announced in Montgomery County, Maryland, in which we are participating in a limited partnership with that county's Housing Opportunities Commission (HOC) and the investment arm of the Potomac Electric Power Company (PEPCO). Montgomery County is acquiring 32 single-family homes through an inclusionary zoning program and is making them available as low-income rental units by using the tax credit.

#### FANNIE MAE'S ROLE IN ASSISTING HOME BUYERS IN DISTRESSED REGIONS

Mr. Chairman, in your letter of invitation, you asked whether the high foreclosure rates in the "oil patch" would preclude secondary market commitments to lower-income borrowers in those states. The answer is no.

Fannie Mae's business in these states demonstrates forcefully one of the primary benefits we provide: our consistent support in all economic circumstances and across all areas of the country. When the energy belt experienced a severe downturn beginning in 1986, Fannie Mae was one of the few companies that remained in the market, and we have every intention of continuing that support. In 1986 and 1987, Fannie Mae purchased approximately \$7 billion in mortgages in Texas, assisting over 107,000 Texas home buyers and homeowners to finance their mortgages. We also purchased \$136 million of mortgage revenue bonds in Texas last year, which will provide financing for roughly 1,720 families who are predominantly first-time home buyers. In addition, we contributed \$50,000 to help finance New Home Ownership Protective Effort (HOPE) franchisees in Dallas, Fort Worth and Houston. HOPE provides a full range of counseling and support services to unemployed and underemployed families who are seriously delinquent in their mortgage payments, and in danger of losing their homes through foreclosures.

We have continued lending in Alaska, Colorado, Louisiana and Oklahoma. In 1986-1987, we purchased \$4.73 billion in mortgage loans in these states and helped almost 74,000 borrowers. We also purchased \$498 million of mortgage revenue bonds that provided financing for roughly 7,720 families who are predominantly first-time home buyers.

We also have initiated a broad loan modification program in the oil patch states to help people stay in their homes. We have worked closely as well with the Alaska Housing Finance Corporation to help resolve the difficult situation in that state.

Despite troubled economic circumstances, we have remained in the oil patch states. We have not lost faith in these markets. When they begin to grow, we intend to grow with them, and we believe our support over the last two or three tough years will stand us and these areas in good stead.

#### IMPROVEMENTS TO ASSURE SERVING COMMUNITY CREDIT NEEDS

From a secondary market perspective, Fannie Mae can make two important contributions to support CRA. First, we will continue to place a high priority on seeking ways to improve our underwriting guidelines, consistent with our responsibility to our shareholders. We welcome all suggestions, and I can promise you we will review them seriously. Second, our Office of Low- and Moderate-Income Housing will pursue aggressively new opportunities to assist lower-income families to achieve homeownership. We believe that our efforts can encourage and assist lenders to meet the needs of lower-income families and help revitalize older urban neighborhoods.

The evolution of public-private partnerships to address housing issues offers a promising starting point. But, the federal government can also provide vital leadership for these efforts. It can, for example, enhance these efforts through initiatives such as preserving the low-income housing tax credit and the municipal revenue bond program. As I noted earlier, we have found the tax credit a superb vehicle for encouraging nonprofit and corporate support for low-income housing needs. And, we believe Congress should give priority to ensuring its availability on a permanent basis.

We have had a very positive experience working with state and local governments to provide the benefits to first-time home buyers of tax-exempt mortgage revenue bonds. We believe these benefits should continue beyond the scheduled sunset date of the end of 1988.

These are only a few examples of the ways government can magnify and encourage the participation of the private sector in meeting the housing needs of lower-income families. The National Housing Task Force, established under the aegis of Senators Cranston and D'Amato, and on which Fannie Mae's Chairman and CEO David Maxwell serves as Vice Chairman, will be issuing next week a comprehensive list of recommendations for implementing a national housing policy. Many of these ideas can also provide vital support for CRA, and we encourage the Congress -- and this Committee particularly -- to give them the highest priority.

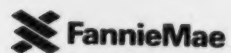
#### SUMMARY AND CONCLUSION

No other company in the conventional mortgage market consistently provides the support Fannie Mae has offered low- and moderate-income families in achieving homeownership. We recognize that we have made mistakes, and we appreciate new perspectives on ways to prevent them in the future. We are always open to new ideas that will help us improve the way we carry out our mission.

Because of this mission, we feel a special responsibility to provide the highest level of support for the goals of CRA. We commend the efforts of the NHA, ACOFH and others in bringing their concerns to us and initiating discussions which have helped us improve our underwriting guidelines. We welcome the interest of all community groups in this important issue. And, we look forward to working closely with them in the future to find the best way to support low- and moderate-income families seeking homeownership.

Thank you, Mr. Chairman. I am happy to answer any questions that you or other members of the Committee may have.





## **Fannie Mae's Low- and Moderate-income Housing Initiatives**

December 1987

### **Chairman's message**

"This report chronicles Fannie Mae's initiatives in serving the housing needs of families and individuals with modest incomes. Together with the formation of our Office of Low- and Moderate-Income Housing Initiatives, it reflects Fannie Mae's strong commitment to providing flexible, affordable financing vehicles for home buyers and renters who are most in need of this assistance."

*David O. Maxwell*

David O. Maxwell  
Chairman and  
Chief Executive Officer

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## Introduction

## Fannie Mae's role in mortgage finance

Fannie Mae (the Federal National Mortgage Association) is a private shareholder-owned corporation that was chartered by the U.S. Congress to help insure a steady flow of mortgage funds in all of America's housing markets. The company does this by operating in the secondary mortgage market—the market that links those who originate mortgages with those who invest in them. By improving the efficiency of that linkage, Fannie Mae helps increase the supply of mortgage capital and makes home loans available at lower interest rates than would otherwise be possible.

Fannie Mae provides funds for residential mortgages in two ways. First, the company purchases mortgages for its portfolio. It finances those purchases by selling debt securities to investors. Second, Fannie Mae issues and guarantees Mortgage-Backed Securities (MBS) that are backed by loans written by mortgage lenders. Together, these two mechanisms increase the pool of potential investors in home loans and allow Fannie Mae to offer the widest possible range of mortgage products.

Fannie Mae acquires home mortgages from—and issues MBS on behalf of—a network of 3,600 primary mortgage lenders in all regions of the country. Approximately 50 percent of the company's business is with mortgage

bankers; 36 percent of Fannie Mae's business is with thrift institutions; the remainder of the company's business is with commercial banks and others in the marketplace, including state and local housing finance agencies.

Operating under limits established in its Charter Act, Fannie Mae serves a broad array of America's low-, moderate-, and middle-income families. Between January 1986 and June 1987, Fannie Mae helped provide affordable mortgage funds to almost 2 million households. The average size of all home mortgages purchased during that period was about \$64,000; nearly 30 percent of all loans purchased were under \$40,000.

Because Fannie Mae is limited by law to the single business of residential finance, the company provides an assured source of support for mortgage lending that is available in all areas of the country and during all economic circumstances.

Fannie Mae is headquartered in Washington, DC. It operates regional offices in Atlanta, Chicago, Dallas, Los Angeles, and Philadelphia. Fannie Mae Software Systems in Norcross, Georgia develops and markets mortgage processing and servicing software products.

## Fannie Mae's low- and moderate-income housing initiatives

Because of the key position it occupies in the nation's housing finance system, Fannie Mae has a unique opportunity to support efforts to expand housing opportunities for low- and moderate-income families and individuals. As noted in the previous section, in carrying out its basic mission, Fannie Mae helps make housing more affordable for all Americans. In addition, Fannie Mae is undertaking an increasing number of initiatives specifically designed to improve the access of low- and moderate-income people to decent, affordable housing. These initiatives are the subject of this publication.

### Programs targeted to low- and moderate-income households

Working in partnership with states, localities, nonprofit organizations, and other corporations, Fannie Mae is developing and implementing a series of programs targeted to lower income home buyers and renters. These efforts—which are ongoing in 38 states and the District of Columbia—include:

- **Tax-exempt financing programs for low- and moderate-income home buyers.** This year, Fannie Mae initiated a program to purchase tax-exempt mortgage revenue bonds that are issued by state and local agencies. By purchasing these bonds, Fannie Mae reduces the agencies' borrowing costs. This, in turn, makes mortgages available for first-time

home buyers at lower interest rates than would otherwise be possible. Fannie Mae expects to help make homeownership affordable for more than 20,000 low- and moderate-income families in 1987 through the purchase of tax-exempt bonds.

Fannie Mae also provides credit enhancement for single-family tax-exempt mortgage revenue bonds. Under this program, Fannie Mae issues Mortgage-Backed Securities that are backed by mortgages funded with the proceeds of tax-exempt bonds. Fannie Mae's involvement enhances the credit of the issuing agencies. This allows them to raise funds at lower costs.

- **Single-family loan-purchase programs.** Fannie Mae works with nonprofit corporations, public agencies, and private lenders to purchase mortgages made to low- and moderate-income home buyers who would otherwise be priced out of the market. These programs typically involve a subsidy that is provided by a state or local government or by a nonprofit organization. They emphasize the rehabilitation of vacant and abandoned houses in targeted neighborhoods, and they often involve the participation of local community development corporations. Through October 1987, Fannie Mae had such programs under way in eight cities and the District of Columbia.

## Programs

- **Multifamily loan-purchase and tax-exempt financing programs.**

On a case-by-case basis, Fannie Mae purchases mortgages on multifamily rental projects serving low- and moderate-income households. Fannie Mae has also helped state and local housing finance agencies provide rental housing for lower income families by using its Mortgage-Backed Securities as collateral for the agencies' tax-exempt bonds. Since 1984, Fannie Mae has provided such credit enhancement for more than 400 projects with almost 60,000 dwelling units.

- **Low-income rental housing equity investments.** Since the Congress authorized the low-income rental housing tax credit program in 1986, Fannie Mae has made commitments to invest more than \$30 million in rental housing projects for low-income families and the homeless. These projects will assist about 1,300 households, while helping rehabilitate vacant and underutilized buildings in selected neighborhoods.

**Fannie Mae's Office of Low- and Moderate-Income Housing Initiatives**

To help promote further efforts on behalf of lower income households, Fannie Mae recently has created an Office of Low- and Moderate-Income Housing Initiatives. This office is responsible for managing the programs that Fannie Mae already has under way and for creating ad-

ditional programs to expand the housing opportunities of low- and moderate-income families and individuals. The staff of this office—and staff of Fannie Mae's five regional offices—are available to work with mortgage lenders, state and local housing agencies, non-profit organizations, and other private corporations to help develop effective programs designed to meet local housing needs in communities throughout the country.

For additional information concerning the Office of Low- and Moderate-Income Housing Initiatives, contact:

Martin D. Levine  
Vice President—Low- and Moderate-Income Housing  
Fannie Mae  
3900 Wisconsin Avenue, NW  
Washington, DC 20016-2899  
(202) 537-6099

**How to use this publication**

The remainder of this publication describes low- and moderate-income housing initiatives that Fannie Mae currently has under way. The descriptions indicate where each program is operating; how the program works; what Fannie Mae's role is; who our partners are; and where one can get additional information.

An additional section describes the work of the Fannie Mae Foundation, which also supports housing affordability efforts, among other goals. The publication concludes with a listing of Fannie Mae's regional offices.

## Apartment Improvement Program (AIP)—Neighborhood Housing Services (NHS)

### Where is the program operating?

Minnesota, New York, Ohio, and Washington, DC.

### How does the program work?

The Neighborhood Reinvestment Corporation (NRC), a national nonprofit agency, coordinates a network of more than 200 Apartment Improvement Program (AIP) and Neighborhood Housing Services (NHS) projects in more than 130 U.S. cities. The goal of the programs is to improve the quality of life for lower income tenants of multifamily housing projects.

In October 1984, Fannie Mae issued a \$25 million master commitment to Neighborhood Housing Services of America (NHSA)—an affiliate of NRC—to support the AIP and NHS programs throughout the United States. Through this master commitment, NRC and NHSA obtain long-term rehabilitation financing for lower income multifamily projects in target cities, thus increasing the availability of decent, affordable rental housing. NRC and NHSA review all requests for financing and forward to Fannie Mae those requests that are approved.

Both investor-owned rental properties and cooperative projects are eligible. First mortgages are conventional, fixed-rate loans, with terms of 7 to 15 years; 20-year self-

liquidating mortgages with up to 30-year amortization are also possible. The maximum loan-to-value ratio is 80 percent.

### What is Fannie Mae's role?

By purchasing the mortgages under the AIP/NHS programs, Fannie Mae serves as the ultimate investor. Through May 1987, Fannie Mae has bought more than \$13 million in rehabilitation loans, helping to make available more than 650 rental units in Minnesota, New York, Ohio, and Washington, DC.

### Who are Fannie Mae's partners?

The Neighborhood Reinvestment Corporation, Neighborhood Housing Services of America, and their local network of nonprofit programs.

### Where can I get more information?

At Fannie Mae, contact:  
Martin Levine  
(202) 537-6030

At the Neighborhood Reinvestment Corporation, contact:  
Muriel Lipit  
(914) 633-4314

At Neighborhood Housing Services of America, contact:  
Mary Lee Widener  
(415) 832-5542

## Concord Park

### Where is the program operating?

Staten Island, New York.

### How does the program work?

Fannie Mae is working with the New York City Housing Partnership (NYCHP) and Norstar Mortgage to enable between 160 and 170 families now priced out of the housing market to purchase new homes.

Norstar Mortgage is originating and servicing the first mortgages. The NYCHP is making second mortgages, through an Urban Development Action Grant (UDAG), available to families who meet program income and credit guidelines. Payment of the second mortgage is not required until the property is sold, and then only if the property is sold for a profit. If the buyer remains in the home for 15 years, the second mortgage is forgiven entirely; if the buyer sells the home before 15 years have elapsed, the second mortgage is repayable from the net profit on resale, unless resale is to another income-eligible buyer.

### What is Fannie Mae's role?

Fannie Mae is purchasing \$6 million to \$7 million in conventional first mortgages.

### Who are Fannie Mae's partners?

- The New York City Housing Partnership (NYCHP).
- Norstar Mortgage Corporation.

### Where can I get more information?

At Fannie Mae, contact:  
Irene Baggio  
(215) 674-1487

At the New York City Housing Partnership, contact:  
Kathryn Wyde  
(212) 561-3001

At Norstar Mortgage, contact:  
Lawrence Strauss  
(816) 832-6378



## Credit enhancement for tax-exempt-financed rental housing developments

### Where are projects financed by tax-exempt bonds located?

Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Illinois, Indiana, Iowa, Kansas, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Dakota, Oklahoma, South Dakota, Tennessee, Texas, Utah, Virginia, and Washington.

### How the program worked

Under this program—known as "Muni Mae"—Fannie Mae has helped state and local housing finance agencies provide rental housing for low- and moderate-income families by using its Mortgage-Backed Securities (MBS) as collateral for the agencies' tax-

exempt housing bonds. The triple-A rating of bonds collateralized with Fannie Mae MBS enabled bond issuers to reduce their financing costs significantly and to pass on those savings in the form of lower rents.

All of the projects financed under this program have set aside a minimum of 30 percent of their units for low-income tenants. Although deliveries are still being made under the Muni Mae program, commitments are no longer available.

### What is Fannie Mae's role?

Under the Muni Mae program, Fannie Mae provided credit enhancement for \$1.793 billion in bonds issued to finance 417 multifamily projects in 29 states:

| State        | Number of Projects | Number of Units | Mortgage Loans Made With Proceeds of Tax-Exempt Bonds* |
|--------------|--------------------|-----------------|--------------------------------------------------------|
| Georgia      | 9                  | 1,450           | 46.9                                                   |
| Mississippi  | 1                  | 392             | 10.0                                                   |
| Tennessee    | 2                  | 448             | 14.6                                                   |
| Indiana      | 6                  | 1,332           | 42.1                                                   |
| Iowa         | 1                  | 210             | 5.3                                                    |
| Minnesota    | 5                  | 563             | 25.7                                                   |
| Nebraska     | 4                  | 408             | 10.7                                                   |
| North Dakota | 7                  | 547             | 12.4                                                   |
| South Dakota | 4                  | 244             | 6.2                                                    |
| Arkansas     | 4                  | 876             | 21.0                                                   |
| Colorado     | 3                  | 792             | 28.2                                                   |
| Kansas       | 5                  | 828             | 15.1                                                   |
| Missouri     | 10                 | 1,390           | 63.9                                                   |

| State         | Number of Projects | Number of Units | Mortgage Loans Made With Proceeds of Tax-Exempt Bonds* |
|---------------|--------------------|-----------------|--------------------------------------------------------|
| New Mexico    | 20                 | 3,773           | 110.8                                                  |
| Oklahoma      | 5                  | 1,006           | 20.3                                                   |
| Washington    | 114                | 10,758          | 308.6                                                  |
| Texas         | 25                 | 6,067           | 198.0                                                  |
| Arizona       | 14                 | 3,072           | 74.5                                                   |
| California    | 101                | 14,081          | 475.3                                                  |
| Nevada        | 4                  | 483             | 15.9                                                   |
| Utah          | 34                 | 5,006           | 132.0                                                  |
| Connecticut   | 6                  | 573             | 15.5                                                   |
| Massachusetts | 16                 | 862             | 30.7                                                   |
| New Jersey    | 3                  | 720             | 28.2                                                   |
| New York      | 9                  | 690             | 17.3                                                   |
| Virginia      | 2                  | 1,011           | 32.8                                                   |
| Delaware      | 1                  | 234             | 5.4                                                    |
| Illinois      | 1                  | 63              | 5.2                                                    |
| Michigan      | 2                  | 580             | 19.6                                                   |
|               | 417                | 59,038          | 1,793.0                                                |

\*Dollars in millions

### Who are Fannie Mae's partners?

State and local housing finance agencies.

### Where can I get more information?

At Fannie Mae home office contact:  
Gerald La Haie  
(202) 537-7065

### Regional office contacts:

Atlanta: Robert Hunter  
(404) 385-6046  
Chicago: David Shelby  
(312) 368-6265  
Dallas: Harry Deavon  
(214) 770-7579  
Los Angeles: John Delaney  
(213) 209-6341  
Philadelphia: H. Gerald Ninos  
(215) 674-1442

## Credit enhancement for tax-exempt-financed single-family mortgages

**Where is the program operating?**  
California, Georgia, and Kentucky.

**How does the program work?**  
Fannie Mae has developed two credit enhancement programs for single-family mortgage revenue bonds issued by state and local housing finance agencies (HFAs). In the first, credit enhancement is provided by Fannie Mae Mortgage-Backed Securities (MBS) that are backed by mortgages funded with bond proceeds. The second program provides credit enhancement with a direct corporate guarantee rather than with MBS.

**What is Fannie Mae's role?**  
Three prototype transactions utilizing the MBS have been completed. These transactions, which total \$90 million, have provided below-market

financing for approximately 1,800 low- and moderate-income families in west central Kentucky and in the cities of Atlanta, Georgia and Thousand Oaks, California.

**Who are Fannie Mae's partners?**  
• State and local housing finance agencies.

**Where can I get more information?**  
At Fannie Mae, contact:  
John Gallagher  
(202) 537-6607

## Energy-Efficient Mortgages

**Where is the program operating?**  
Arkansas, Connecticut, Idaho, Montana, Oregon, Texas, Vermont, Virginia, and Washington State. More than 100 smaller utilities offer rating programs to help buyers qualify for energy-efficient mortgages.

**How does the program work?**  
Through its Energy-Efficient Mortgage (EEM) loan options, Fannie Mae recognizes that homes built or renovated with high-efficiency heating and cooling equipment, adequate insulation, and other energy-saving measures are worth more and cost less to run. Buyers of energy-efficient new and older homes can get an Energy-Efficient Mortgage that allows them to qualify for a higher loan amount than if they were purchasing an inefficient home. In addition, buyers of older homes can get an EEM that enables them to include in their mortgage the cost of energy-saving improvements.

The EEM options can improve housing affordability, particularly for first-time home buyers. In cooperation with lenders, builders, electric and gas utilities, real estate agents, and public interest groups, Fannie Mae promotes energy-efficient housing along with the EEM loan options.

**What is Fannie Mae's role?**  
Fannie Mae offers the EEM loan options to its network of over 4,000 approved lenders. The lenders determine whether to offer it in the communities they serve.

Fannie Mae sponsored several pilot projects with consumer groups, lenders, utilities, and others to demonstrate and refine the company's EEM loan options. One pilot is now under way in Connecticut to develop and test new underwriting guidelines and to prepare a complete marketing program for the EEM that involves real estate agents, lenders, and others involved in the home purchase process.

## Home Ownership Protective Effort (HOPE)

Fannie Mae is jointly sponsoring the pilot with the Alliance to Save Energy and Conn Save, Inc., two nonprofit groups that promote investment in energy-efficient housing.

Fannie Mae has provided lenders with consumer brochures that explain the EEM, bank counterchecks, and other marketing materials. The company also provides technical advice to organizations such as Energy Rated Homes, a national nonprofit group that conducts home energy audits.

### Who are Fannie Mae's partners in the EEM program?

- Fannie Mae-approved lenders that are willing to offer the EEM option.
- The Alliance to Save Energy, Washington, DC.

- Conn Save, Inc., Hartford, Connecticut.
- Energy Rated Homes of Arkansas, Washington, and Vermont.

### Where can I get more information?

At Fannie Mae, contact:  
John Nevin  
(202) 537-7514

At The Alliance to Save Energy, contact:  
James Wolf  
(202) 867-0666

At Energy Rated Homes, contact:  
Ronald Hughes  
(501) 374-7827

### Where is the program operating?

- Currently: McKeesport and Erie, Pennsylvania; Cleveland and Youngstown, Ohio.
- Planned: Dallas and Houston, Texas.

### How does the program work?

The Home Ownership Protective Effort (HOPE) program of Housing Opportunities, Inc.—a nonprofit tax-exempt social services corporation in McKeesport, Pennsylvania—provides a full range of counseling and support services to unemployed and underemployed families who are seriously delinquent and in danger of losing their homes through foreclosure. HOPE has an impressive record of success—only 12 foreclosures in its first 725 cases.

HOPE's clients are referred by (and their fees paid by) mortgage lenders, utility companies, and mortgage investors. No charge is made to the clients. Services provided to homeowners include: comprehensive financial counseling; access to community resources and public programs such as food banks, job retraining and vocational programs,

and family counseling services; cash assistance through low-interest deferred loans; and advocacy and assistance in negotiations with creditors.

HOPE chooses communities in which to establish its offices through an exhaustive analysis of local conditions and services. It then selects a local nonprofit organization and franchisees it, training its staff in all the services HOPE offers.

### What is Fannie Mae's role? Fannie Mae's role in the HOPE program is fourfold:

- Fannie Mae has signed a contract for client referrals to HOPE's four existing franchisees in Pennsylvania and Ohio.
- We have made a \$50,000 commitment to help finance two new HOPE franchisees in Dallas and Houston.
- The Fannie Mae Foundation has made a \$25,000 philanthropic donation to Housing Opportunities, Inc. for its Revolving Loan Fund for needy families.

- We are continuing to make contacts on HOPE's behalf with other major mortgage investors and agencies.

**Who are Fannie Mae's partners?**

- Housing Opportunities, Inc., McKeesport, Pennsylvania.
- Fannie Mae's approved lenders, which refer families with serious delinquencies to HOPE programs.
- Other mortgage lenders and insurers, including the Mortgage Guaranty Insurance Corporation and the U.S. Department of Housing and Urban Development, which has contracted with HOPE for several years.

**Where can I get more information?**

At Fannie Mae, contact:  
Lynne Ballew  
(202) 537-7473

At Housing Opportunities, Inc., contact:  
James Butler  
(412) 664-1590

## HomeSight

**Where is the program operating?**  
Washington, DC.

**How does the program work?**

HomeSight is a public/private partnership intended to make homeownership a possibility for lower income families who are now priced out of the housing market. It is also designed to increase the capacity of local community development corporations (CDCs) to produce affordable housing for members of their neighborhoods.

Under the HomeSight program, CDCs identify vacant and abandoned properties and buy and rehabilitate them with technical assistance and financial support from the Local Initiatives Support Corporation (LISC). The CDCs may use their own development teams or participate in joint ventures with other developers.

CDCs market the rehabilitated properties to qualified low- and moderate-income purchasers. Those buying homes under this program must have incomes no greater than 80 percent of the area median income. The home buyers finance

their purchases with a combination of first mortgages provided by Fannie Mae-approved lenders and interest-free second mortgages provided by the District of Columbia's home purchase assistance programs.

**What is Fannie Mae's role?**

The Fannie Mae Foundation helped spearhead a campaign to raise \$500,000 for LISC's revolving loan fund. This \$500,000 will be matched by an equal amount from LISC's national office and will be used by the CDCs to acquire and rehabilitate homes.

Fannie Mae has agreed to purchase up to \$15 million in first mortgages on HomeSight properties from five local lenders. This will help make possible approximately 300 home purchases.

Fannie Mae also worked with participating Washington, DC lenders to develop and implement the guidelines for HomeSight loans.

## Lake Park Townhomes at Klahanie

### Who are Fannie Mae's partners?

- The District of Columbia Department of Housing and Community Development.
- The national and Washington, DC offices of the Local Initiatives Support Corporation.
- Washington-area community development corporations:
  - H Street Community Development Corporation.
  - Kenilworth-Parkside Resident Management Corporation.
  - MANNA, Inc.
  - Marshall Heights Community Development Organization.
  - MUSCLE (Ministries United to Support Community Life Endeavors).
  - Neighborhood Housing Services.
  - Northeast Community Development Corporation.
  - Peoples Involvement Corporation.

- Washington-area lenders:
  - American Security Bank.
  - First American Bank.
  - Independence Federal Savings and Loan.
  - Inter-City Mortgage Corporation.
  - Washington Mortgage Group/National Bank of Washington.
- The U.S. Department of Housing and Urban Development (HUD) and the Veterans Administration (VA), through the bulk sale of HUD- and VA-held properties to CDCs.

### Where can I get more information?

At Fannie Mae, contact:  
Lynne Ballew  
(202) 537-7473

At the Local Initiatives Support Corporation in Washington, DC, contact:  
Michael Mayer  
(202) 296-4380

For more information about the Fannie Mae Foundation, contact:  
Harriet Ivey  
(202) 364-4927

### Where is the program operating?

Seattle, Washington.

### How does the program work?

The King County Housing Finance Agency (KCHFA) has implemented a program to require that developers provide social benefits in return for zoning density bonuses. As part of that program, Lake Park Townhomes at Klahanie involves a set-aside for lower income families of 28 townhomes to be built by an established nonprofit housing developer in a new high-density development. The project also will involve a set-aside of Mortgage Credit Certificate authority from the Washington State Housing Finance Commission in the amount of \$1.8 million.

KCHFA is providing second mortgages on favorable terms to borrowers who meet income and credit guidelines. Borrowers are providing 5 percent cash down payments. The construction financing and the permanent conventional first mortgages will be originated and serviced by Continental Mortgage Company.

### What is Fannie Mae's role?

Fannie Mae has agreed to purchase the 28 first mortgages from Continental.

### Who are Fannie Mae's partners?

- The King County Housing Finance Agency.
- The Washington State Housing Finance Commission.
- Continental Mortgage Company.
- Environmental Works, Inc., a nonprofit developer.

### Where can I get more information?

At Fannie Mae, contact:  
James Blakeley  
(213) 299-6434

At Continental Mortgage Company, contact:  
Jeff Todhunter  
(206) 455-4888



## Martin Luther King Subdivision Program

**Where is the program  
operating?**  
Champaign, Illinois.

### **How does the program work?**

The City of Champaign is providing \$10,000 grants for down payments to lower income families who qualify under Fannie Mae income and credit guidelines, permitting those families to purchase new homes in this subdivision. The homes—three-bedroom, two-bath ranch houses—will sell for an average price of \$54,000. Most first mortgages will have loan-to-value ratios greater than 80 percent and will have appropriate mortgage insurance coverage.

Firstbank Mortgage will originate and service the first mortgages, which will be purchased by Fannie Mae.

**What is Fannie Mae's role?**  
In addition to purchasing the first mortgages, Fannie Mae is waiving its normal requirement that a minimum 5 percent down payment come entirely from the home buyer's own funds.

### **Who are Fannie Mae's partners?**

- The City of Champaign, Illinois.
- Firstbank Mortgage.

### **Where can I get more information?**

At Fannie Mae, contact:  
William Tierney  
(312) 365-6261

With the City of Champaign,  
contact:

Betty McKown  
(217) 351-4486

At Firstbank Mortgage Company,  
contact:  
Ann Schrader  
(217) 395-6888

## National Temple

**Where is the program  
operating?**  
Philadelphia, Pennsylvania.

### **How does the program work?**

The National Temple project will preserve and renovate 20 units of rental housing in North Philadelphia. The units will be occupied by low-income families who are receiving rental subsidies through the Philadelphia Housing Authority. National Temple Non-Profit Corporation, which will rehabilitate and manage the units, is a minority-controlled community development corporation that has already produced 250 units of lower income housing in North Central Philadelphia.

Approximately \$1.4 million in financing for the project is being provided through a variety of private, state, local, and foundation sources, as well as through the syndication of a limited partnership for equity investment.

**What is Fannie Mae's role?**  
Fannie Mae has made a \$570,000 equity investment as sole limited partner in the National Temple project. The partnership, syndicated by the Enterprise Social Investment Corporation, enables Fannie Mae to take advantage of the low-income housing tax credit created by the 1986 Tax Reform Act.

### **Who are Fannie Mae's partners?**

- The Enterprise Foundation
- The Enterprise Social Investment Corporation
- National Temple Non-Profit Corporation
- Cigna Corporation
- Mellon Bank
- Philadelphia Housing Authority

### **Where can I get more information?**

At Fannie Mae, contact:  
Martin Levine  
(202) 637-6030

At National Temple Non-Profit  
Corporation, contact:  
Marie Nahikian  
(215) 787-2790

At the Enterprise Social Investment  
Corporation, contact:  
Leslie Powell  
(301) 964-0552

## New York City Low-Income Rental Housing Rehabilitation Program

**Where is the program operating?**  
New York City.

**How does the program work?**  
This project will rehabilitate 1,000 units of permanent rental housing for the homeless and very-low-income people of New York City. Vacant, city-owned buildings in the Bronx, Brooklyn, and Manhattan will be purchased and rehabilitated under the auspices of the Enterprise Foundation and local nonprofit community support groups.

The \$70 million project is being financed through a variety of private, state, local, and foundation sources, as well as through the syndication of a limited partnership for equity investment.

**What is Fannie Mae's role?**  
Fannie Mae has made a \$28 million equity investment as a limited partner in the project. The partnership, syndicated by the Enterprise Foundation, enables Fannie Mae to utilize the low-income housing tax credit created by the 1986 Tax Reform Act.

**Who are Fannie Mae's partners?**

- The Enterprise Foundation.
- The Enterprise Social Investment Corporation.
- The New York Homeless Housing Assistance Program.
- The New York State Housing Trust Fund.
- The New York City Department of Housing Preservation and Development.

**Where can I get more information?**

At Fannie Mae, contact:  
Martin Levine  
(202) 537-6030

At The Enterprise Foundation, contact:  
Helen Szablya  
(301) 964-1230

## Purchase of tax-exempt mortgage revenue bonds

**Where is the program operating?**

Alabama, Colorado, Florida, Georgia, Louisiana, Minnesota, Missouri, Oklahoma, Texas, and Washington State.

**How does the program work?**

In March 1987, Fannie Mae began a program to purchase tax-exempt mortgage revenue bonds issued by state and local housing finance agencies to fund mortgages on single-family homes. The program's goal is to provide affordable housing for approximately 23,000 low- and moderate-income first-time home buyers.

**What is Fannie Mae's role?**

By purchasing the bonds directly, Fannie Mae reduces the agencies' marketing costs, making it possible for them to offer mortgages at lower interest rates than otherwise

would be possible. In negotiating with the issuing agencies, Fannie Mae also encourages them to offer additional subsidies to home buyers, making homeownership more affordable to lower income families.

As of October 1, 1987, Fannie Mae had purchased \$1.03 billion in bonds, helping provide below-market-rate mortgage financing for 20,000 first-time home buyers.

**Who are Fannie Mae's partners?**

State and local housing finance agencies.

**Where can I get more information?**

At Fannie Mae, contact:  
John Gallagher  
(202) 537-6607

| Agency                                             | Bonds<br>Purchased<br>(\$ in millions) | Estimated<br>Number of<br>Borrowers |
|----------------------------------------------------|----------------------------------------|-------------------------------------|
| Florida Housing Finance Agency                     | 118.4                                  | 2,400                               |
| Washington State Housing Commission                | 67.5                                   | 1,300                               |
| Houston Housing Finance Corporation                | 50.0                                   | 1,000                               |
| DeKalb County (GA) Housing Authority               | 75.0                                   | 1,500                               |
| Cities & Metro Counties of<br>Minneapolis/St. Paul | 198.5                                  | 3,900                               |
| Oklahoma Housing Finance Agency                    | 208.7                                  | 4,100                               |
| City & Metro Counties of Denver                    | 80.0                                   | 1,600                               |
| Missouri Housing Finance Agency                    | 75.0                                   | 1,500                               |
| Alabama Housing Finance Agency                     | 72.0                                   | 1,440                               |
| Jefferson Parish (LA) Housing<br>Finance Agency    | 38.6                                   | 770                                 |
| Urban Residential Finance<br>Authority (Atlanta)   | 43.5                                   | 870                                 |

## Seafirst Rehabilitation Loan Program

**Where is the program operating?**  
Seattle, Washington.

**How does the program work?**  
The goal of the program is to provide homeownership opportunities for lower income families through the rehabilitation of vacant and abandoned housing. Seafirst Real Estate Group, an affiliate of Seafirst Bank, has targeted low- and moderate-income neighborhoods in central and southwest Seattle that have been earmarked for revitalization by HUD and the Washington State Housing Finance Commission.

There are two phases to the Seafirst program. In the first, loans for acquisition of properties and credit lines for the costs of rehabilitation are made available to builders, developers, and non-profit organizations. In the second, market-rate first mortgages are made available to low- and moderate-income home buyers. To enhance affordability, Seafirst also assists the home buyers in applying for public subsidy programs.

**What is Fannie Mae's role?**  
Fannie Mae has worked with Seafirst to develop appropriate credit guidelines for the program and will purchase \$25 million in conventional first mortgages to provide home financing for approximately 500 low- to moderate-income families in the Seattle area.

**Who are Fannie Mae's partners?**  
• Seafirst Real Estate Group

**Where can I get more information?**  
At Fannie Mae, contact:  
Lynne Ballew  
(202) 537-7473

At Seafirst, contact:  
Ron Campbell  
Rehabilitation Loan Department  
(206) 358-3542

## The Walk Home Program

**Where is the program operating?**  
Chicago, Illinois.

**How does the program work?**  
The Walk Home program is a joint venture of Neighborhood Housing Services (NHS) of Chicago and the Greater North Pulaaki Development Corporation (GNPDC) to encourage employees of GNPDC-member companies to purchase homes near their work places. The program reduces employees' transportation costs and helps improve the stability of their neighborhoods.

Participating member companies of GNPDC invest in the Walk Home Revolving Loan Fund, from which their employees may borrow up to \$8,000 in second mortgage funds to supplement their down payments. The second mortgages will be serviced by NHS. The first mortgages will be originated and serviced by three approved Fannie Mae lenders.

The properties being purchased are existing area homes with an average first mortgage of \$50,000. Mortgage insurance is required for loans with loan-to-value ratios greater than 80 percent.

**What is Fannie Mae's role?**  
Fannie Mae will purchase the first mortgages from the three participating lenders.

**Who are Fannie Mae's partners?**

- Neighborhood Housing Services of Chicago.
- The Greater North Pulaaki Development Corporation.
- Three participating Fannie Mae lenders.

**How can I get more information?**  
At Fannie Mae, contact:  
William Tierney  
(312) 365-6251

At Neighborhood Housing Services of Chicago, contact:  
Donna Davy  
(312) 235-2188

## Wood Street Commons

**Where is the program operating?**  
Pittsburgh, Pennsylvania.

**How does the program work?**  
The Wood Street Commons project will preserve and substantially renovate 270 single-room occupancy units of permanent housing in a historic YMCA. One hundred thirty-six of the units will be reserved for homeless and very-low-income people at subsidized rents. Social and other support services will be provided to residents through public and nonprofit offices located in the building.

The project is being financed through a variety of private, state, local, and foundation sources, as well as through the syndication of a limited partnership for equity investment.

**What is Fannie Mae's role?**  
Fannie Mae has made a \$2 million equity investment as sole limited partner in the Wood Street Commons project. The partnership, syndicated by the Enterprise Foundation, enables Fannie Mae to utilize the low-income housing tax credit created by the 1986 Tax Reform Act, as well as the historic preservation tax credit.

**Who are Fannie Mae's partners?**

- The Enterprise Foundation.
- The Enterprise Social Investment Corporation.
- The Ford Foundation.
- Community Human Services, Inc.
- Tom Mistick and Sons.
- The Allegheny Conference.
- The City of Pittsburgh and County of Allegheny.

**Where can I get more information?**

At Fannie Mae, contact:  
Martin Levine  
(202) 537-6630

At the Enterprise Foundation, contact:  
Heleen Suabiyah  
(301) 964-1230

At Tom Mistick and Sons, contact:  
Jane Clark  
(412) 322-1121

## The Fannie Mae Foundation

## The Fannie Mae Foundation

Since its establishment in 1979, the Fannie Mae Foundation has provided grants to qualifying non-profit organizations in the areas of housing and community development, arts and culture, health, and social concerns. In conjunction with the formation of the Fannie Mae Office of Community Relations in late 1986 as part of the Department of Corporate Affairs, the Foundation's budget and activities were expanded to include the funding of housing and community development.

The 1987 contributions plan for the Foundation includes funds for low-income housing, homelessness, and research and public policy development programs. Approximately 20 percent of these funds are available for regional grants.

The Foundation's support is often granted in partnership with Fannie Mae's programs to support the housing needs of lower income families. For example, along with the Foundation support provided to the Local Initiatives Support Corporation (LISC), The Enterprise Foundation, and Housing Opportunities, Inc., a business and/or investment relationship also exists. Additionally, through its Department of Corporate Affairs, Fannie Mae has provided public relations and pro bono professional fundraising services in support of these projects.

For more information about the Fannie Mae Foundation, contact Harriet Ivey, vice president for community relations, at (202) 364-4927.

## Fannie Mae Offices



The CHAIRMAN. Very good. Thank you.  
Mr. Brendsel.

**STATEMENT OF LELAND C. BRENDEL, PRESIDENT AND CEO,  
FEDERAL HOME LOAN MORTGAGE CORPORATION**

Mr. BRENDEL. Thank you, Mr. Chairman.

My name is Leland Brendel and I'm president and chief executive officer of the Federal Home Loan Mortgage Corporation, better known as Freddie Mac. I certainly appreciate this opportunity to appear before you today. We commend you for holding these hearings.

Freddie Mac strongly supports the objectives of the Community Reinvestment Act and all congressional efforts to ensure that conventional mortgages are available in all communities.

Mr. Chairman, you helped create Freddie Mac to increase the availability and affordability of conventional residential mortgages that could meet investment standards of private institutional investors. As you know, we do that by purchasing mortgages from lenders and then selling securities backed by those mortgage pools.

Freddie Mac's investors now include pension funds, insurance companies and many other types of financial institutions.

You have my written statement for the record, but I'd like to answer the questions that you recently sent me and tell you why I believe that Freddie Mac is part of the solution to meeting communities' mortgage credit needs.

First, Freddie Mac has not imposed new restrictions which I believe could adversely affect lenders in carrying out their CRA responsibilities. To the extent that borrowers are told by lenders that their applications have been denied because of increased secondary market restrictions, I'm concerned by this. It may be that Freddie Mac is more often the excuse than the real reason that a loan may not be made. In fact, Freddie Mac has consistently made a market in low downpayment loans throughout our 18-year history. We make a market in conventional loans all day every day, no matter how volatile the markets are.

Despite higher foreclosure rates in the oil patch States, Freddie Mac remains in those markets, depressed ones as well as prosperous ones, and inner city as well as rural. We buy loans of any amount from small as well as large lenders. In fact, 21 percent of the new loans we purchased last year were under \$40,000, affordable by households earning under \$16,000 per year.

We constantly reassess and respond to changes in the entire marketplace. When we find a barrier to our ability to help to serve the market, we try to eliminate it and sometimes that can involve your help in changing our charter.

**FREDDIE MAC'S ROLE IN MULTIFAMILY HOUSING**

In an era of shrinking Federal involvement in housing, Freddie Mac's role in the multifamily market has become critical. The data show that our multifamily programs help to finance and improve apartments for thousands of low and moderate income renters. The key was persuading community-based lenders who had never made a multifamily mortgage that they could originate and sell loans on

apartment buildings. That made multifamily financing available in inner city neighborhoods. In fact, when we were recently told that a minimum loan amount was a barrier to inner city lending, multifamily lending, we eliminated that minimum.

The numbers speak for themselves. Since 1982, Freddie Mac's purchase of multifamily loans has increased twenty fold. According to the New York Times, Freddie Mac is the largest source of multifamily loans for low and moderate income housing in the five boroughs in New York.

For home buyers, Freddie Mac has consistently made a market in low downpayment mortgages permitting a loan of 95 percent of the value of a home. But contrary to popular belief, our proven underwriting guidelines are not written in stone. Lenders have much flexibility in underwriting loans to be sold to Freddie Mac. In fact, when we are made aware of underwriting guidelines that pose particular problems, we try to resolve those problems.

Mr. Chairman, all of this is by way of saying that Freddie Mac and the secondary market are part of the solution to redlining concerns. Our goal is to facilitate access to mortgage credit by persuading investors like pension funds and insurance companies that the residential mortgage is as sound an investment, as a AAA bond.

That ends my statement.

[The complete prepared statement of Leland C. Brendsel follows:]

## Fannie Mae Offices

### Home Office

2800 Wisconsin Avenue, NW  
Washington, DC 20016-2899  
(202) 537-7000

### Northeastern Regional Office

510 Walnut Street—16th Floor  
Philadelphia, PA 19106-3697  
(215) 574-1400

Areas served: Connecticut, Delaware,  
District of Columbia, Maine, Maryland,  
Massachusetts, New Hampshire, New  
Jersey, New York, Pennsylvania, Puerto  
Rico, Rhode Island, Vermont, Virgin  
Islands, Virginia, West Virginia.

### Southeastern Regional Office

260 East Paces Ferry Road  
Atlanta, GA 30328-1161  
(404) 365-6000

Areas served: Alabama, Florida, Georgia,  
Kentucky, Mississippi, North Carolina,  
South Carolina, Tennessee.

### Midwestern Regional Office

One South Wacker Drive—Suite 3100  
Chicago, IL 60606-6867  
(312) 641-0740

Areas served: Illinois, Indiana, Iowa,  
Michigan, Minnesota, Nebraska, North  
Dakota, Ohio, South Dakota, Wisconsin.

### Southwestern Regional Office

Two Galleria Tower  
13455 Noel Road—Suite 600  
Dallas, TX 75240-5003  
(214) 991-7771

### Mailing Address:

P.O. Box 650043  
Dallas, TX 75265-0043

Areas served: Arkansas, Colorado,  
Kansas, Louisiana, Missouri, New Mexico,  
Oklahoma, Texas.

### Western Regional Office

P.O. Box 24019  
10920 Wilshire Blvd.—Suite 1800  
Los Angeles, CA 90024-6519  
(310) 296-4234

Areas served: Alaska, Arizona,  
California, Guam, Hawaii, Idaho,  
Montana, Nevada, Oregon, Utah,  
Washington, Wyoming.

### Fannie Mae Software Systems

3139 Campus Drive  
Norcross, GA 30071-1402  
(404) 446-2533

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STATEMENT OF

LELAND C. BRENDEL

PRESIDENT AND CHIEF EXECUTIVE OFFICER

FEDERAL HOME LOAN MORTGAGE CORPORATION

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

U.S. SENATE

MARCH 23, 1988

Mr. Chairman and Members of the Committee. My name is Leland Brendel and I am President and Chief Executive Officer of the Federal Home Loan Mortgage Corporation, better known as Freddie Mac. I appreciate this opportunity -- my first opportunity as President of Freddie Mac -- to appear before your distinguished Committee to address questions about the secondary mortgage market and the Community Reinvestment Act.

BACKGROUND

By way of background, Freddie Mac is a publicly-chartered corporation whose stock is owned by savings institutions across the nation. We were created by Congress in 1970 to increase the availability and affordability of conventional residential mortgage funds for homebuyers. Freddie Mac accomplishes this by purchasing mortgages from lenders nationwide, thereby replenishing their supply of funds to relend to homebuyers. We package these mortgages into pools, and then sell securities backed by these pools. These mortgage-backed securities are then sold to institutional investors, such as pension funds and insurance companies. In this regard, Freddie Mac is not a retail lender and has no direct contact with borrowers, as such. We do not make mortgage loans; rather, we purchase loans from lenders.

We commend you for holding these hearings today. Freddie Mac strongly supports the objectives of the Community Reinvestment Act and all congressional efforts to ensure that mortgage credit is available to qualified borrowers in all communities.

Recently, consumer concerns about lender compliance with the Community Reinvestment Act have raised questions concerning whether the secondary market increases pressure on lenders to avoid making loans in certain areas. We believe that the secondary market facilitates mortgage lending by making more money available to lend in all neighborhoods. We have seen no evidence to suggest that our presence does otherwise.

#### The Creation of Freddie Mac

Freddie Mac was the pathfinder in developing the link between the capital markets and local conventional mortgage markets. We were also a pioneer in developing uniform underwriting guidelines, innovative mortgage programs and mortgage-backed securities. These developments have become standards for the industry. They may now seem simple, but it took many years of carefully assessing the needs of the marketplace and the diverse interests of lenders, homebuyers and investors to arrive at the marketplace we have today.

The notion that the secondary market might inhibit lenders' ability to make loans in certain areas runs contrary to the fundamental reason the secondary market exists: that is, to increase the availability of mortgage funds to borrowers. We have linked the capital-rich areas of the country - like the Northeast - to other regions of the country which might otherwise not have access to a ready supply of mortgage capital. In this way, mortgage money is accessible to small as well as large institutions; in inner city as well as

rural locations; in depressed markets as well as prosperous ones. This link provides an additional benefit to borrowers: not only is mortgage credit as readily available in Texas as it is in New York, but interest rates are unaffected by the property's location.

We provide credit for low-balance as well as higher-balance loans, affordable by low- to moderate-income homebuyers nationwide. Although Freddie Mac's 1987 loan purchase limit was \$153,100, and the average loan we purchased was about \$65,000, twenty percent of the new loans we purchased were under \$40,000. Those loans of under \$40,000 are affordable by households making \$16,000 a year.

In fact, Freddie Mac purchases much smaller loans each and every day, and we will purchase them one at a time. Lenders know they can sell Freddie Mac any loan, no matter how small, any time. When we were able to eliminate a minimum loan purchase amount a few years ago, more than 600 additional lenders began to sell loans to us. In this way, Freddie Mac facilitates origination of small loans to households of very modest income.

#### Underwriting Residential Mortgages

But when Congress directed that Freddie Mac make mortgages more available, it also warned "against the accumulation of high risk mortgages which could jeopardize the soundness of the Corporation." The Conference Report to our authorizing legislation emphasized that:

"... in order to protect the Corporation from becoming a 'dumping ground' for mortgages rather than a truly secondary facility, the bill requires that mortgages to be purchased shall be deemed by the Corporation to 'be of such quality, type, and class as to meet generally the purchase standards imposed by private institutional mortgage investors.'"



As a result, Congress Incorporated in Freddie Mac's charter specific conditions on purchasing loans in excess of 80% of the value of the property. Freddie Mac can only buy lower downpayment loans if: (1) the seller retains a participation in the loan; (2) the seller agrees to repurchase the loan upon default; or (3) any balance greater than 80% is insured by private mortgage insurance.

We determine if a loan is of the required investment quality through underwriting. Underwriting involves reviewing the borrower's credit record as well as the value of the property securing the mortgage. Freddie Mac defines an investment quality mortgage as a loan to a borrower from whom timely repayment of the debt can be expected and that is secured by real property that provides sufficient value to recover the lender's investment if a mortgage default occurs.

Sound underwriting is the key to assuring that borrowers will keep their homes: just as no borrower wants to lose his or her home, no lender or investor wants to own it by default.

To carry out our investment quality mandate, Freddie Mac wrote the first set of uniform underwriting guidelines for conventional mortgages. The underwriting guidelines are, however, just that — guidelines. Lenders have much flexibility in underwriting loans for Freddie Mac.

A good example of this flexibility is the ratio of a household's income to projected housing expenses. Our guidelines suggest that a borrower devote 25-28% of their income to housing expense. Contrary to popular belief, these

ratios are not written in stone. It may be that the borrower has traditionally devoted a greater portion of their income to housing expense. Our guidelines make clear that lenders have the flexibility of judging the willingness and ability of each borrower to repay their loan.

Another example of this flexibility relates to the treatment of non-traditional sources of income. Child support payments, workers' compensation benefits, disability retirement payments, certain types of public assistance payments — all of these are counted as income for underwriting purposes. In fact, we encourage lenders to give special consideration to borrowers who have verified non-taxable income.

We try to communicate this flexibility to our customers, the mortgage lenders. We work closely with them through seminars, meetings, regular updates to our Sellers' and Servicers' Guide, and other publications (such as our underwriting guidelines booklet). In 1988, we will sponsor roughly 210 of these lender seminars throughout the country.

#### Responding to Change

We have never forgotten the need to reassess and respond to changes to the entire marketplace. This includes our ability to continue to purchase loans from low-to-moderate income homebuyers.

Although the risks of default from making low downpayment loans are greater, Freddie Mac has consistently made a market in low down payment mortgages with 95% loan-to-value ("LTV") ratios. We recognize that first time as well as

low-income borrowers typically have difficulty accumulating a downpayment, and so require a loan of 95% of the value of the property. In fact, Freddie Mac, in our eighteen year history, has never restricted or limited these loans.

Whenever we encounter underwriting obstacles that we can address without undermining the investment quality standard, we remove them. A good example is a problem we recently solved in Milwaukee, Wisconsin.

Before 1987, Freddie Mac could purchase a loan on a nonconforming property (for example, a four-unit building in a neighborhood recently re-zoned for one-unit dwellings) only if there was a governmental assurance that should the property be heavily damaged, it could be rebuilt to its original specifications.

This requirement was a problem, especially in certain urban areas. It was hindering many potential homebuyers, including lower income homebuyers from getting loans on city properties. This reality caused us to reassess very carefully the risk of not obtaining formal assurance of rebuilding for each and every loan. As a result, we eliminated the requirement.

#### The Secondary Market in Multifamily Mortgages

In an era of shrinking federal involvement in rental housing, Freddie Mac's role in the multifamily market has become increasingly important. In fact, our multifamily programs help finance rental housing for thousands of low and moderate income households.

Freddie Mac's sustained commitment to the multifamily market has really paid off over the past few years. Local lenders who had never made a multifamily mortgage learned that, with our assistance, they could originate and sell a multifamily loan. These nontraditional multifamily lenders have benefitted from the increased origination and servicing income that these loans produce.

And this recent, increased competition in multifamily lending has benefitted borrowers and tenants as well. Multifamily loans are now available in inner city neighborhoods at competitive rates, no matter how small the building or the loan. Increased financing of multifamily buildings has also meant money available to make needed improvements to maintain or rehabilitate rental housing.

The numbers speak for themselves. Since 1982, Freddie Mac's purchases of multifamily loans has increased at least twenty-fold. In fact, according to the New York Times, Freddie Mac is the largest source of multifamily funds for low- and moderate-income rental housing for New York City and its boroughs. Overall, rents on multifamily loans which Freddie Mac purchases are well below the HUD fair market rents. I have included with my testimony for the record a comparison of market rents for select metropolitan areas.

But multifamily lending is still evolving, and we continue to reassess needed changes. For example, in response to concerns that our \$100,000 minimum loan amount was a barrier, we have eliminated the minimum loan amount.

The CHAIRMAN. Thank you very much, Mr. Brendsel. Your statement will be printed in full in the record.

Mr. Carlton, yesterday a group of Philadelphia banks with excellent community reinvestment records declared that private mortgage insurers have abandoned their affirmative lending efforts.

Furthermore, we understand this problem is reported in another half dozen cities.

I know that mortgage insurance is a business and your industry has suffered massive losses recently. Nevertheless, if this report is true, it suggests that you've decided that deserting our low income neighborhoods even where there are respected willing lenders will help your industry's woes. What's your proof that this would be the case?

Mr. CARLTON. I'm not familiar with the Philadelphia situation other than I know that one of our companies has its home office up there and they feel like that they are involved in that activity and it's a community service that they perform.

Insofar as MI companies lending inner city, we entertain the applications that are sent to us on an individual company basis.

The CHAIRMAN. It's my understanding that private insurers are pulling out of Philadelphia's reinvestment plan, not because of losses, but because they think their profits are lower and they can make more elsewhere.

FHA is not pulling out of Philadelphia but it is now reaching out through banks there to serve more low income borrowers. Banks didn't want to do business with FHA before but they are doing it now.

So the point is that both FHA and private issuers need to do more, not less. What's your reaction to that?

Mr. CARLTON. We entertain the applications that are sent into us by our lenders. I'm not familiar—I'm not licensed in Pennsylvania, but if—

The CHAIRMAN. Well, respond if you can for the record. I would appreciate that.

[The information referred to was subsequently provided for the record:]

CONCLUSION

We believe that Freddie Mac and the secondary market is part of the solution to the redlining problem. Throughout our history and never more so than today, our goal has been to equalize access to credit. By persuading investors like pension funds and insurance companies that a conventional mortgage is as good an investment as a triple-A bond, Freddie Mac has increased the availability and affordability of mortgage money.

I would be happy to answer any questions you may have.

Robert  
Hans Linn  
Manager  
Comptroller

William R. Thomas, Jr.  
Executive Vice President  
Operations  
760/799-6310

March 17, 1988

Mr. Gale Cisnoetta  
Chairperson  
National People's Action  
614 W. Washington Blvd.  
Chicago, IL 60607

Dear Mr. Cisnoetta:

I am writing to provide you with an update on the progress Freddie Mac has made in its review of the issues raised by Mr. Calvin Bradford in his letter dated November 18, 1987.

It is quite clear from his letter that Mr. Bradford possesses a very good understanding of the historical background of the various appraisal theories which are used to address changing property values. We thank Mr. Bradford for providing us with his valuable insight and perspective of these very important issues.

Mr. Bradford's letter focused on three issues of concern for community groups representing low- and moderate-income people. The first two issues involve Freddie Mac making changes in two of its publications, the Underwriting Guidelines booklet and the Sellers' and Servicers' Guide (the "Guide"). The third issue relates to Freddie Mac's involvement in and support of local housing reinvestment programs.

As you are aware, we have been in the process of revising the Underwriting Guidelines booklet for the last several months. Initially, we had hoped to have the new booklet ready and distributed by the first quarter of 1988. For reasons unrelated to the issues and concerns raised by National People's Action, the revision is currently behind schedule. However, the delay does have its good side in that the new booklet will now have the benefit of Mr. Bradford's comments and suggestions.

We agree with Mr. Bradford that the language on neighborhood analysis and redlining included in the 1977 edition of our Guidelines is superior to the current language. As a result, we have reinserted the previous language into our new 1988 edition. We certainly agree that the message is as appropriate today as it was ten years ago, especially for those newer underwriters unaware of the redlining issues of the 1970s. There will be changes to several of the sections with the intention of improving and strengthening the message.

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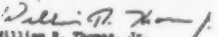
Mr. Gale Cincotta  
March 17, 1988  
Page 2

The second major issue is the Hallara' and Servicers' Guide. We believe we can better define redlining in the Guide and perhaps provide examples of the different types of redlining, for example, racial/ethnic redlining, and age of neighborhood redlining. Further, we believe that we can emphasize that redlining can occur in either the appraisal or underwriting process. Again, we found Mr. Bradford's suggestions valuable and will address the issues appropriately in future Guide revisions.

The third major issue involves Freddie Mac's participation in local reinvestment programs. Freddie Mac believes we can become even more involved in programs designed for community development that combine acceptable risk with the flexibility necessary to make such programs successful. As a result, Freddie Mac is examining the process by which we could increase the flow of funds to these neighborhoods through our existing purchase programs. In this regard your thoughts and suggestions would be welcomed.

We appreciate your interest in our programs and policies and look forward to continuing our working relationship with representatives of National People's Action.

Cordially,

  
William R. Thomas, Jr.  
Executive Vice President-Operations

WRT:RBD

TABLE 1  
AVERAGE MONTHLY RENT IN SELECTED CITIES DURING 1987

| Metropolitan Area          | Average Rent in Buildings<br>That Secure Mortgages<br>Purchased by Freddie Mac | HUD Fair<br>Market Fair <sup>1</sup> |
|----------------------------|--------------------------------------------------------------------------------|--------------------------------------|
| Los Angeles-Long Beach, CA | \$535                                                                          | \$616                                |
| Washington, DC-MD-VA       | 438                                                                            | 563                                  |
| Miami-Mialeah, FL          | 415                                                                            | 520                                  |
| Atlanta, GA                | 370                                                                            | 477                                  |
| Chicago, IL                | 391                                                                            | 539                                  |
| Indianapolis, IN           | 314                                                                            | 376                                  |
| Baltimore, MD              | 363                                                                            | 479                                  |
| Detroit, MI                | 388                                                                            | 478                                  |
| Newark, NJ                 | 445                                                                            | 530                                  |
| New York, NY               | 382                                                                            | 503                                  |
| Cleveland, OH              | 355                                                                            | 415                                  |
| Philadelphia, PA-NJ        | 379                                                                            | 474                                  |
| Memphis, TN-AR-MS          | 336                                                                            | 364                                  |
| Seattle, WA                | 415                                                                            | 465                                  |
| Milwaukee, WI              | 370                                                                            | 431                                  |

<sup>1</sup> Estimated rent as of April 1, 1987 for two-bedroom apartments within the metropolitan area, as published in the Federal Register, April 29, 1987 and June 30, 1987.

Note: A multifamily mortgage is secured by a property with at least five housing units.



TABLE 2  
PERCENT OF U.S. HOUSEHOLDS THAT RENT  
BY INCOME QUINTILE

| Quintile          | 1973 | 1983 |
|-------------------|------|------|
| Lowest 20 percent | 49%  | 56%  |
| 20 - 40 percent   | 46%  | 47%  |
| 40 - 60 percent   | 36%  | 37%  |
| 60 - 80 percent   | 28%  | 24%  |
| 80 - 100 percent  | 18%  | 12%  |

Source: American Housing Survey

TABLE 3  
MULTIFAMILY ORIGINATIONS AND FREDDIE MAC PURCHASES

| Year                          | Freddie Mac<br>Multifamily<br>Mortgage Purchases | Conventional<br>Multifamily<br>Originations | Ratio of Purchases<br>to Originations<br>(in percent) |
|-------------------------------|--------------------------------------------------|---------------------------------------------|-------------------------------------------------------|
| -----billions of dollars----- |                                                  |                                             |                                                       |
| 1982                          | \$ .1                                            | \$ 7.5                                      | 1                                                     |
| 1983                          | .3                                               | 17.5                                        | 2                                                     |
| 1984                          | .7                                               | 22.9                                        | 3                                                     |
| 1985                          | 1.5                                              | 28.4                                        | 5                                                     |
| 1986                          | 3.6                                              | 40.7                                        | 9                                                     |
| 1987                          | 2.1                                              | 37.0(e)                                     | 6                                                     |

e - Estimated by Freddie Mac

Source: Freddie Mac and U.S. Department of Housing and Urban Development.

Table 4  
1988 Revisions to Freddie Mac's Underwriting Guidelines

The following language will be included in the 1988 Underwriting Guidelines:

**PROPERTY REQUIREMENTS**

"When reviewing the appraisal report, the underwriter should consider the totality of the report, not just an individual item, in determining if the appraisal adequately supports the estimated market value and the acceptability of the property. When evaluating whether the estimate of market value is appropriately documented and supported by the data in appraisal report, the underwriter functions as a reviewer of the work of the appraiser. To determine if the loan is appropriate for the property, the underwriter relates all specific data and comments of the appraiser, not just the final estimate of value, to the loan terms.

The concept of an investment-quality loan recognizes both the need for an accurate appraisal of current fair market value and the legitimate underwriting interest in the property's future value. In estimating this future value, primary focus is given to evaluating the risk of value decline in the early years of the loan. This focus is appropriate because the early years of the loan are generally those with the greatest exposure to risk. First, the risk of a value decline is not normally due to a long-term downward trend in value, but to the possibility that the decline in value may occur during the early years of the loan when borrower equity in the property may be small. Second, the further into the future that values are projected, the more imprecise and subjective the projections are likely to become.

In evaluating the risk of value decline, it is important to recognize that one particular factor adversely affecting the current market value does not necessarily indicate a risk of continued value decline. If the appraisal report has recognized this factor, the impact on market value has already been reflected. To also reduce the loan-to-value (LTV) ratio because of this factor is an unnecessary double adjustment to the loan, and the underwriter should review the loan accordingly."

**NEIGHBORHOOD ANALYSIS**

"Location is a basic consideration in property appraising and financing real estate. It must be emphasized, however, that the racial composition of a neighborhood is not considered by Freddie Mac to be a relevant appraisal factor and must not be considered in the appraisal report or in any analysis of any section of the appraisal report. Many stable and viable neighborhoods are composed of residents of varied and diverse racial and cultural backgrounds. Ethnic factors are also not reliable as indicators of value trends or loan quality. In addition, Federal laws and regulations make it unlawful to base loan decisions on the racial composition of a neighborhood, a practice known as "redlining."

Redlining is interpreted in various ways. As mentioned above, locational factors are basic to prudent underwriting. Redlining, in very general terms, means the withdrawal of conventional mortgage funds from an area due to perceived property risks which are based on improper locational factors such as race, ethnic composition, etc."

"Sound underwriting should always be based on realistic perceptions of risk. Redlining, however, occurs when perceptions of risk are based on factors that do not reliably predict risk, or when automatic unfavorable loan terms based on geographical area are arbitrarily assigned. An example of a factor which does not predict risk is race. Redlining using this factor is called "racial redlining" and is illegal under Federal law. Other factors or terms that are used to indicate racial composition, such as "pride of ownership," are equally impermissible. It is necessary to be sensitive to such terms or factors. The automatic use of unfavorable loan terms is inconsistent with proper underwriting, which is intended to relate individual loan applications to specific property.

Freddie Mac does not intend any provision of these guidelines to foster redlining as it is discussed above."

**STABLE INCOME AND SECONDARY INCOME**

"Stable monthly income is the borrower's gross monthly income from primary base employment plus recognizable secondary income.

Secondary income from bonuses, commissions, overtime, or part-time employment should be recognized as "stable monthly income" only if such items are typical for the occupation and substantiated by the borrower's previous year's earnings, and if continuation of this income is probable based on foreseeable economic circumstances. Some minority group members and low to moderate income families tend to rely more heavily on secondary income, and care should be taken that consideration of such income is not discriminatory or artificially restrictive of opportunities for home financing.

When reviewing an application, you must consider the overall picture of the quantity, quality and durability of a borrower's income or secondary income. Assessment must be made without regard to the borrower's race, color, religion, national origin, age, sex, or marital status. In evaluating the loan, you cannot seek information from the borrower about childbearing plans or use of birth control practices. In analysis of the quality and durability of the borrower's income, the underwriter may recognize all, none, or a portion of the income, depending upon the presentation, but cannot use any point or credit scoring plan to discriminate on the basis of the race, color, religion, national origin, age, sex, or marital status of the borrower."

**INCOME RATION**

"Somewhat higher percentages than the above may be appropriate with respect to lower income borrowers because such borrowers tend to devote a higher percentage of income to basic needs, such as housing. Review the borrower's previous monthly housing expense and total debt payment and relate these to the proposed monthly housing expense and total debt payments. Consideration must be given to borrowers who have maintained a good credit history and accumulated savings while their housing expense and debt ratios have exceeded these guidelines."

# Bulletin

Volume 1  
Number 1  
October 1987

Number 07-12

TO: All Freddie Mac Sellers and Servicers September 30, 1987

Several changes to our *Sellers' and Servicers' Guide* have been approved recently that were not incorporated into the fourth quarter update, which you should receive shortly. This bulletin addresses these changes and should be retained after you receive the fourth quarter update.

- Changes in the following areas are discussed in detail in this bulletin:
- interest rate buydown plans
  - zoning restrictions for legal nonconforming 1-4 family properties
  - multifamily Plan B mortgages in Massachusetts
  - master title insurance policies
  - ALTA title insurance policy warranties for multifamily mortgages
  - ARM origination language for notes from lenders regulated by the Comptroller of the Currency
  - an authorized change to Kentucky's adjustable-rate mortgage notes
  - reminder on the Consolidation, Extension, and Modification Agreement for New York
  - transfers of servicing
  - clarification on submitting Form 993, Report of Tax Information on Acquisitions and Abandonments

## Interest rate buydown plans

To address unexpected rapid increases in mortgage interest rates, Freddie Mac has developed a policy of allowing "unplanned buydowns" for owner-occupied and nonowner-occupied (NOC) 1-4 family properties effective immediately. The paragraphs below compose a new subsection to section 1403 of the *Sellers' and Servicers' Guide*.

**Unplanned buydowns.** In the calculation of the total value of financing concessions, Freddie Mac does not include amounts paid as an "unplanned buydown." Freddie Mac defines an unplanned buydown as funds paid at closing by the builder, developer, property seller, or other interested party to reduce the effective interest rate on the borrower's mortgage to a rate closer to or equal to the rate specified in the sales contract. Unplanned buydowns arise from an increase in mortgage market interest rates between the date of the sales contract and the date of the loan closing. Typically, unplanned buydowns arise in new construction cases. During construction but before mortgage closing, prevailing interest rates in the mortgage market rise and the builder increases the amount of his financing concessions, using funds from his profit margin to maintain the sales contract financing terms.

In order to be considered an unplanned buydown, the following conditions must be met:

- The sale price of the property must be fixed in the sales contract and the transaction must be closed at that price.
- The terms of the financing must be contained in the sales contract. The interest rate is either specified in the contract or adequately identified (for example, prevailing VA rate) in the contract.
- The amount paid as an unplanned buydown must have been caused by an increase in mortgage market interest rates between the date of the contract and the closing date.
- Any unplanned buydown that is a temporary subsidy buydown plan must comply with the other provisions of this section, including the prohibitions against interest rate buydown plans on nonowner-occupied properties or in connection with Freddie Mac's ARM or GPM purchase programs.

When the HUD-1 closing statement discloses financing concessions that exceed Freddie Mac's limits and an unplanned buydown was involved, the Seller's file must contain a written analysis and documentation evidencing that the unplanned buydown met each of the above conditions.

The following items are not considered by Freddie Mac to be unplanned buydowns and must not exceed the limits specified by Freddie Mac for financing concessions:

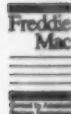
- costs and charges to which the property seller agreed in the sales contract
- costs and charges resulting from the financing terms contained in the sales contract being more favorable to the borrower than market conditions that existed as of the date of the sales contract

## zoning restrictions

To make financing more readily available particularly for urban housing, we have reevaluated our policy on legal nonconforming 1-4 family properties. As a result, section 2309 of the guide is changed as follows effective immediately:

The mortgagee promises must conform to applicable zoning and use restrictions and enable the mortgage to qualify as a home mortgage as defined in section 8012. Freddie Mac may, however, purchase a home mortgage secured by property that does not conform to applicable zoning and use restrictions but is a "legal use" (known as "legal nonconforming use"). The appraiser must comment on any adverse effect of any nonconforming usage when estimating the market value and marketability of the property.

Freddie Mac's policy on legal nonconforming multifamily properties (section 2104) and on condominiums (section 3001) is not affected by this change.



# Bulletin

Special  
Guide  
Volume 1

Number 68-5

TO: All Freddie Mac Sellers and Servicers

February 19, 1988

During the past few years, Freddie Mac's multifamily mortgage purchase programs have enjoyed tremendous acceptance from investors and lenders. In a continuing effort to provide useful and efficient products for lenders who originate multifamily mortgages, we are pleased to announce several changes to our programs and policies. Some of the most beneficial enhancements are:

- lower fees
- reduced documentation
- increased flexibility in program requirements

Unless otherwise noted, the following revisions are effective immediately and apply to all multifamily programs. The changes will appear in a forthcoming update to our Sellers' and Servicers' Guide.

#### Loan review fees and offer limits (sections 2601, 2603, and 2605)

Effective April 1, 1988, for the immediate delivery program, the loan review fee of \$2,500 will be reduced to \$1,500. In addition, offers under this program will be limited to one mortgage per contract.

#### Recalculation fee elimination (section 2902)

Under the prior approval program, when the Seller selects an alternative required net yield and requests an increase in the maximum mortgage amount, the Seller no longer must forward a recalculation fee of \$1,000 on each submission to the applicable regional office. However, the Seller must continue to forward a commitment fee equal to 2 percent of the amount by which the mortgage is increased. At funding, Freddie Mac will continue to refund 1.5 percent of the mortgage amount as increased.

#### Transfer fee (section 7310)

Freddie Mac has reduced the nonrefundable transfer fee for Plan B mortgages closed on or after April 1, 1988 to the greater of \$750 or 0.5 percent of the unpaid principal balance. Freddie Mac will continue to require a transfer fee equal to the greater of \$750 or 1 percent of the unpaid principal balance for Plan B mortgages closed before April 1, 1988.

#### Prepayment charge (section 3108)

The prepayment charge of 1 percent of the principal balance has been eliminated during the last six months of the mortgage term for both Plan A and Plan B mortgages closed on or after April 1, 1988. The authorized wording to FHMA/FHLMC Uniform Instruments regarding this change is attached.

#### Management plan (section 1807)

To reduce documentation, the Seller is no longer required to submit a management plan for the project. The Seller will be responsible, however, for approving the borrower's proposed or present management plan before submitting the mortgage to Freddie Mac.

#### Certificate of occupancy (sections 3702 and 3802)

Freddie Mac has eliminated the requirement for the certificate of occupancy when both circumstances below exist:

- Private institutional mortgage investors in the area where the mortgaged premises are located do not commonly require a certificate of occupancy.
- There are no circumstances or conditions involving legally approved occupancy requirements of which the Seller is aware that would adversely affect value or marketability of the mortgaged premises or mortgage.

#### Minimum mortgage amount (section 3116)

The minimum mortgage amount for both Plan A and Plan B mortgages has been eliminated.

#### Maximum per unit mortgage amount (section 3102)

As a result of the enactment of the Housing and Community Development Act of 1987, the multifamily maximum per unit mortgage amount is increased effective for all mortgages closed on or after February 5, 1988.

The original amount of a multifamily mortgage must not be more than the following applicable limit per unit:

#### RESIDENTIAL STRUCTURES

| Number of bedrooms<br>in family unit | Maximum mortgage<br>amount per unit |
|--------------------------------------|-------------------------------------|
| 0                                    | \$31,607                            |
| 1                                    | 35,100                              |
| 2                                    | 41,025                              |
| 3                                    | 51,675                              |
| 4                                    | 59,500                              |

April 6, 1988

**Mortgage  
Insurance  
Companies  
of America**

The Honorable William Proxmire  
Chairman - Banking, Housing and  
Urban Affairs  
Room 350 Dirksen Senate Office Building  
United States Senate  
Washington, DC 20510

Dear Senator Proxmire:

You asked me to respond for the record on behalf of MICA to your assertion that "both FHA and private insurers need to do more, not less" in their efforts in reaching out to serve more low income borrowers. I believe that there is universal agreement with you within the mortgage insurance industry. MICA has repeatedly testified that the most efficient housing policy involves a balance between the efforts of the government and private sector so to maximize the benefits available to families seeking housing.

Your reference to "redlining" or setting up obstacles for homeownership in areas where low income borrowers are located is, as best as can be determined, not contemplated nor implemented by any firm in the private insurance industry. We believe that any allegations of redlining should be supported with a factual basis. For example, there have been press reports which indicate insurers have tightened underwriting guides in ways that appear to involve redlining. These reports generally fail to explain that insurers have tightened those underwriting guides that were in effect since the early 1980's and have done so across the board in all market areas. These underwriting changes have been in direct response to mortgage credit risk having changed in recent years. This fact is confirmed by the experience of our industry and that of FSLIC insured institutions. Such press reports should make it clear that the industry has not developed guidelines nor uses guidelines with a purpose to discriminate against those with lower incomes.

You specifically asked about the situation in Philadelphia. My company, Integon Mortgage Guaranty is not licensed in the state of Pennsylvania. However, a member firm of MICA, Commonwealth Mortgage Assurance Company (CMAC) is headquartered in Philadelphia, Pennsylvania, and insures a large percentage of the business in that state. CMAC applies the same underwriting guidelines to all borrowers in Pennsylvania which are the same guidelines that CMAC applies in most of the nation. Further, it should be noted that CMAC's guidelines for the oil patch areas such as Houston, Western Louisiana and Oklahoma are more restrictive than those typical national guidelines which are applied to inner city Philadelphia. The more restrictive guides in the oil patch match specific risk in those areas and actually protect policyholders in other areas from paying higher premiums. Although the experience of insurers in some inner city areas such as in Philadelphia has not been good, they have remained involved. In many cases the insurer's loss ratio (losses paid as percentage of premiums earned) on inner city business has been very high and the rate of applications that are approved for certificates is low. It would be revealing for you to request a specific accounting from the

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Washington, DC 20036  
202-785-0767



group of Philadelphia banks you described in the hearing as to their experience with the private insurers in economic terms. They should include a report of all mortgage loans originated not just in Philadelphia communities but their entire insured loan portfolio and present their insurance experience. In other words, how many loans did they insure, how much premium was collected, and how much was paid in claims. These facts will provide a better understanding of their declaration you described.

I am enclosing a copy of a recent news article covering a mortgage plan in Philadelphia. CMAC has been a participant in that plan from the start and views its involvement as community service. Although the lenders in the plan typically have fixed fees for loan applications, CMAC has maintained a premium rate that is a constant percentage of mortgage amount. It has not changed this policy to compensate for the higher proportional fixed cost of the low balance loans originated in this plan. CMAC typically underwrites two loans at a cost of approximately \$75 in order to receive a \$200 premium from only one of the two loans that is likely to be closed by the lender. CMAC retains into the future the risk of loss from foreclosure of the insured loan which could be substantial.

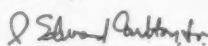
This brings me to the other point you asked about in the testimony, namely that low balance FHA loans appear to be no more accessible than low balance privately insured loans. We believe sufficient evidence exists which will show that lenders price small balance FHA loans higher than larger balance FHA loans. This was discussed during the development of the 1987 Housing Act by the House Housing Subcommittee. After reviewing such pricing evidence involving Pennsylvania loans the Subcommittee passed an amendment to prohibit lenders using FHA to discriminate by price based on loan size.

Your decision to ask FHA for the breakdown of its loans by loan size, the effective cost to the borrower and the location of the property would be very revealing as to the FHA program's effectiveness what you feel would be the so called "redlined" areas. From MICA's analysis of areas and markets where loan risk is higher FHA is not being used by lenders more aggressively to give the low income borrower greater access to credit or to stabilize home values. It is important to examine the track record over a five year period so to adjust the data for specific aberrations that may occur in a year. One would hope the government program would take a leadership role in the high risk areas.

MICA supports lender involvement in local communities and believes that communities undergoing a transition where risks may be higher, deserve special recognition. It is just such areas where government and private sector efforts should be better balanced to increase the effectiveness of both. MICA has urged and will continue to urge Congress to evaluate the benefits that would result to low income borrowers if the availability of government programs for them was greater rather than less than government program availability to higher income borrowers.

I appreciate the opportunity to express views of this industry on the important subject of your hearing.

Sincerely,



J. Edward Carlton, Jr.

/smb

INQUIRY 3/13/88

# Agency provides advice

## Budget strategy for home buyers

By Linda S. Wallace  
Inquirer Staff Writer

The dream of owning a home sometimes turns into a financial nightmare for people who face unexpected repairs or who spend too lavishly to furnish their new home.

To help people make the best of home ownership, the Philadelphia Council for Community Advancement, a United Way agency, offers free financial counseling before and after a home purchase.

Studies have found that the counseling service, which has been used by more than 4,000 families since 1962, has helped reduce the number of people delinquent on mortgage payments, said LaVerne M. Jones, the council's deputy executive director.

For that reason, the Philadelphia Mortgage Plan, a cooperative reinvestment effort by 12 banks to strengthen Philadelphia neighborhoods through home ownership, is pooling its resources with the credit-counseling agency to help low-income home buyers.

The mortgage plan, developed in 1975 by the Greater Philadelphia Partnership (now the Urban Affairs Partnership), has allowed nearly 12,000 families to obtain \$143 million in mortgages on low- and moderate-priced housing.

### Delinquencies on rise

But the delinquency rate on its loans has risen above 20 percent and that fact, coupled with efforts by private mortgage-insurance companies to tighten requirements for low-income home buyers, prompted officials to develop a pilot program that would counsel buyers on the demands of home ownership, said Jeffrey Cruise, the council's executive director.

The new counseling program, the Home Buyer's Advisory Service, began Friday under the council's management. It will offer credit counseling, household-budgeting workshops and advice on home selection. Help also will be available in Spanish.

The council will help families determine the house price they can afford to pay before they buy, thus reducing the potential for financial strain later, Jones said.

When a client finds a house, the agency recommends an in-depth inspection to determine if repairs are needed and then helps the client budget for those costs, Jones said.

### 500 to be aided

"When you are borderline income, you can't absorb the fact that you are spending \$100 a month or \$200 a month extra," Jones said.

Counseling will be provided to 500 home buyers who ask for it either while applying for loans through the Philadelphia Mortgage Plan or by contacting the counseling agency at 567-7803. The families will be tracked for three years to determine how successful they are in meeting their obligations.

Once the home buyers get their mortgages, the agency will help them plan a budget that includes purchases such as furniture, a washer and dryer and a refrigerator.

Participating financial institutions in the Philadelphia Mortgage Plan are Atlantic Financial, Beneficial Savings Bank, Continental Bank, First Pennsylvania Bank, Fidelity Bank, Frankford Trust Co., Germantown Savings Bank, Mellon Bank (East), Meridian Bank, Philadelphia National Bank, Provident National Bank and PSFS.

These lenders will finance mortgages on homes costing up to \$30,000 with down payments ranging from 5 percent to 10 percent. Until Friday, the limit was \$25,000. Interest rates vary, but are as low as 8.75 percent with one point, or 1 percent of the loan amount, charged up front.

Applicants must meet certain credit and income standards.

Gene Austin is away. His column will resume when he returns.

## OBSTACLES FOR LOW-INCOME BUYERS

The CHAIRMAN. Mr. Brendsel, as you know, community groups allege your institutions have set up obstacles for homeownership by lower income buyers. They say you have imposed tighter restrictions, sometimes officially but more often unofficially. The result is that lenders are reluctant to make loans to low income borrowers.

How do you respond? If that's not the case, how are you reassuring lenders that you encourage this lending?

Mr. BRENDSEL. Mr. Chairman, I disagree with the conclusion from that statement. Clearly, as I said in my oral statement as well as the written, that Freddie Mac remains committed to all markets. We remain in all markets, purchasing low downpayment mortgages. We do change our underwriting guidelines from time to time, but certainly not with the intent of making them more restrictive.

The CHAIRMAN. My question then is, How are you reassuring the lenders that you encourage their lending in low-income neighborhoods and ethnic neighborhoods?

Mr. BRENDSEL. First of all, our seller/servicers' guide, which is our contract with our sellers, contains strong statements supporting lending in all neighborhoods.

Second, in our underwriting guidelines booklet, which is an explanation of our underwriting requirements, we are expanding the language to reinforce that our underwriting guidelines are flexible and that they are to be applied in a nondiscriminatory fashion.

Finally, a very important part of Freddie Mac's activity is working with individual sellers explaining our guidelines, so that they can understand and apply them. In this regard, we conduct many seller/servicer educational seminars. In fact, in 1988, we will be conducting over 200 of those seminars to explain those guidelines, and the flexibility embodied in those guidelines.

The CHAIRMAN. Mr. Riordan, do you want to respond to that?

Mr. RIORDAN. Yes, sir. We do two things. The first is that in our underwriting guides we specifically encourage lenders to take advantage of programs that will benefit low- and moderate-income families; and if there are any specific variances from our guidelines that would help, then we ask them to come in and explain them to us.

Second, through our Office of Low- and Moderate-Income Housing, we go out and seek opportunities to get involved with communities and then with our lenders to effect specific transactions.

## DEFAULTS

The CHAIRMAN. Mr. Riordan, yesterday two bankers told us that their lending efforts in low-income neighborhoods are profitable and they expect the default rate will match or better that of the overall bank holding company. Is this forecast consistent with your experience? In recent years you've had plenty of experience with defaults. Do your data show whether or not these loans were concentrated in low-income neighborhoods?

Mr. RIORDAN. The data indicate that we have defaults all over the country, Mr. Chairman, and that they're concentrated in specific parts of the country, but not in particular neighborhoods.

The CHAIRMAN. So that your data shows that the low-income neighborhoods, the minority neighborhoods, the ethnic neighborhoods, have no poorer default rate than the white neighborhoods and the high income neighborhoods?

Mr. RIORDAN. The data aren't conclusive on that, but there's no reason to believe that they are any different on a broad scale depending on the type of neighborhood.

The CHAIRMAN. Have you publicized that? Is that well known and understood and accepted among bankers?

Mr. RIORDAN. I don't think so, Mr. Chairman. One of the things that we're trying to do, through getting involved in specific projects and also in the low-income housing tax credit, is to prove to other lenders that these programs not only can work but that they also can be profitable. And we've looked at these particular transactions that we've gotten involved in during the last 12 to 15 months very carefully, and we have every reason to believe that they will be just as profitable as any package of loans that were made in another neighborhood.

The CHAIRMAN. Let me ask you, Mr. Brendsel, you've given the committee data which shows that in 20 communities with similar populations but different average incomes Freddie Mac has consistently purchased substantially more loans per 1,000 homes in the higher income communities than in the lower income communities. How do you explain that pattern, and could it indicate a bias toward satisfying investors while denying lower income home buyers?

Mr. BRENDSEL. No, I do not believe it indicates a bias along those lines. As far as an explanation for that, I think that one has to look behind those numbers and examine very carefully what those numbers mean. For example, I'm very familiar with one comparison because it's Sioux Falls, SD-Mitchell, SD and I hail from that part of the country. I'm familiar, for example, with the fact that Sioux Falls, SD has much more job growth and economic activity than Mitchell, SD had. And that's borne out also in terms of new originations even in FHA loans, between Sioux Falls and Mitchell. So there can be a variety of economic factors, general economic factors, in those communities that explain those differences.

Clearly, also, there can be other factors influencing those numbers. For example, it may be that Fannie Mae is doing more activity with a given group of lenders in one community than another.

The CHAIRMAN. Still it's hard to accept this. These are 20 communities and this is your data, not data that the committee provided or the critics provide, but your organization provided this, and that shows that Freddie Mac consistently made substantially more loans per 1,000 homes in the higher income communities than the lower income communities. It seems to me that your data is convincing, that there's a bias here in favor of higher income communities, unless you can show that the higher income communities are better risks.

Mr. BRENDSEL. Again, I do not believe there is a bias on Freddie Mac's part because the data does not compare conventional mortgage originations offered for sale into the secondary market with purchases by Freddie Mac. In addition, the data does not account for differences in population and housing units in each ZIP code.



Further, it does not take into account the business competition from Fannie Mae as well as private secondary market purchasers. Finally, it does not reflect whether lenders making loans in the ZIP code are utilizing the secondary market.

However, since this conventional mortgage data is unavailable, one could use FHA endorsements by ZIP code as a rough proxy of origination activity. FHA-insured originations are strongly correlated with conventional activity.

The volume of conventional originations differs across ZIP codes for several reasons. First, the number of homes may differ between the areas. Second, the propensity of the local population to move may vary. Third, the activity of government-supported housing finance programs—both state plans and federal programs such as the FHA, VA, and FmHA—will affect the volume of conventional originations. For these reasons, both conventional originations and Freddie Mac's purchases will vary across areas.

I have included for the record a table showing how Freddie Mac's purchase volume parallels FHA endorsements. In other words, if FHA endorsements are a good proxy for overall loan origination activity, then Freddie Mac's share of the conventional market is roughly the same in the higher- and the lower-income areas. In fact, if it's true that the FHA market share is larger in lower-income ZIP codes—we have no data to substantiate this but it seems to be a reasonable assumption—then the table would imply that conventional originations are probably more than four times larger in the higher-income areas and that Freddie Mac's purchase share is actually *smaller* in the higher-income ZIP codes.

This would be as one would expect, since the loan-size limits that are incorporated in Freddie Mac's charter would limit the Corporation's purchase activity in high-priced housing markets (which presumably house a disproportionate number of higher-income families).

To illustrate this point, let's compare a lower- and a higher-income ZIP code supplied by the Committee: ZIP 135 (Utica, NY) versus ZIP 140 (Buffalo, NY). During 1987, Freddie Mac purchased four times as many home loans in the higher income area, ZIP 140 (2260 loans versus 557 loans). However, the 1980 Census of Housing recorded more than five times as many homes in ZIP 140 (approx-

#### MORTGAGE ACTIVITY IN 1987

|                                      | Number of home mortgages purchased by Freddie Mac in 1987 | Number of FHA single-family endorsements in 1987 |
|--------------------------------------|-----------------------------------------------------------|--------------------------------------------------|
| Twenty-five higher-income areas..... | 72,998                                                    | 73,307                                           |
| Twenty-seven lower-income areas..... | 18,241                                                    | 19,510                                           |
| Total for fifty-two areas.....       | 91,239                                                    | 92,817                                           |
| Total U.S. activity.....             | 1,127,052                                                 | 1,262,129                                        |

Note: The analysis is conducted on the basis of three-digit ZIP codes selected by the Senate Committee on Banking, Housing, and Urban Affairs. Average gross income in 1982 was supplied by the Committee to distinguish higher- and lower-income areas. The ZIP codes included in the higher-income areas are the following: 017, 085, 100, 140, 152, 190, 209, 232, 276, 334, 358, 450, 571, 640, 662, 708, 750, 774, 778, 801, 882, 911, 940, 970, and 990. The lower-income ZIP codes are: 024, 075, 104, 135, 155, 195, 218, 227, 275, 279, 324, 360, 451, 573, 656, 661, 677, 712, 754, 766, 780, 808, 879, 932, 936, 974, and 987.

Source: Freddie Mac and the Federal Housing Administration.



mately 110,000 versus 21,000). Thus, while it appears we purchased fewer loans in the lower-income area, we actually purchased more after controlling for the number of structures.

The CHAIRMAN. Mr. Riordan.

Mr. RIORDAN. Mr. Chairman, let me respond to that because we looked at the same areas, I believe. In nearly every case where we had a pair of high income-low income ZIP code numbers, at least three digit ZIP code numbers, we looked carefully at the areas. And, in almost all cases the lower income area was much more rural. We don't do a lot of business in rural areas. Most of our business is in SMSAs. So with respect to volume, you would expect to see that there would be lower volume there.

The CHAIRMAN. Why don't you do more lending in rural areas?

Mr. RIORDAN. Because most of the loans that are made in rural areas, Mr. Chairman, are related to Farmers Home, Farm Credit, or FHA and VA. And they aren't conventional loans that are typically made in rural areas outside of SMSAs. We of course do business in those areas, but it's not nearly in the same preponderance as in central cities and in the suburbs.

The CHAIRMAN. Mr. Carlton, you allege that FHA has failed to live up to its charter obligation to provide insurance for lower income borrowers. You say this government agency has drifted into higher income neighborhoods. You urge that Congress restrict FHA insurance exclusively to low income borrowing.

Is there any evidence that FHA is closing its doors in any area to low income borrowing or tightening its insurance requirements? Will targeting FHA really solve the very large problem of redlining?

Mr. CARLTON. We think that it will go a long way toward that, yes, sir. A retargeting will do that. I don't believe that we said that they were going exclusively for the upper.

The CHAIRMAN. Well, explain that a little more. How will that solve the problem?

Mr. CARLTON. The FHA is much as we are in that they can only insure loans that are submitted to them. But as a Government entity, they can go out and encourage lenders to make loans to lower income people in the ways that we imply here by helping there be more incentives for the lenders.

The CHAIRMAN. We'll send your information on to FHA and ask for their comment.

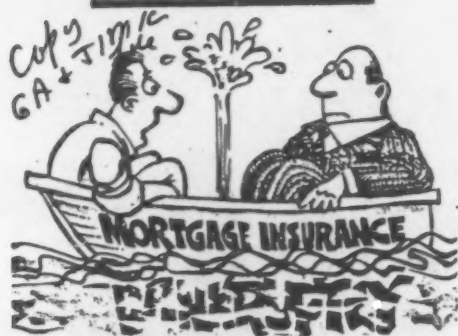
Gentlemen, thank you very, very much. You've been very helpful.

The committee will stand adjourned.

[Whereupon, at 11:55 a.m., the hearing was adjourned.]

[Additional material submitted for the record follows:]

## THE NATION'S HOUSING



## Mortgage Insurance Crisis

By Kenneth R. Harney

If you plan to buy a house in the next year or two with a down payment of less than 20 percent, you're likely to be touched by one of the biggest financial dramas in American real estate.

It could cost you money at settlement. It could directly affect your ability to buy or finance a new first or second home. As a taxpayer, it could force you to pay for unheralded future losses on the horizon at the Federal Housing Administration and Veterans Administration.

The drama is the painful restructuring of an entire industry—the American mortgage-insurance field. For the past eight weeks, the drama has included business-page headlines about the collapse and liquidation of a major firm,

California-based TMIC Insurance Co.

TMIC's demise isn't likely to dent your wallet unless you are a lending institution holding TMIC insurance. The nation's largest home lender, the Federal National Mortgage Association (Fannie Mae), has \$3 billion worth of such loans, for example. Banks, S&Ls and mortgage bankers scattered across the country have multimillion-dollar portfolios of TMIC-insured loans on their books. The bulk of these loans aren't in danger, but some will spill uninsured red ink.

The real story for home buyers, builders, realty brokers and mortgage lenders isn't the TMIC bloodbath. It's the bigger picture—the financial upheaval in mortgage-insurance, one of the least known but most

See HARNEY, FIA, Cal

The Washington Post  
March 12, 1988  
F4

## THE NATION'S HOUSING

## Private Mortgage Insurance Crisis

HARNEY, From F4

important segments of the American home-buying system.

What is mortgage insurance? Why is it apparently in such hot water? And what does the crisis mean to potential buyers, particularly first-timers?

Most consumers first encounter mortgage insurance after they've signed a contract to purchase their home and they're looking for conventional, nongovernmental financing. If they're making a relatively low down payment—from 5 percent to 15 percent—their lender will quote a rate that includes premiums for "PMI," private mortgage-insurance coverage.

Mortgage insurance protects the lender from default losses caused by the borrower. It does not insure the borrower against anything. On high-down-payment mortgages, lenders feel no need for special protection. After all, if a purchaser has forked over 25 or 30 percent of the price of a house in cash, he or she is likely to bend over backwards to avoid default or foreclosure on the loan for the balance.

When buyers put down little cash, however, lenders have good statistical reasons to seek insurance coverage. Private

mortgage insurance covers their exposure to loss to some acceptable level, but nowhere near the full amount of the loan. The uninsured portion normally can be covered through the proceeds of a foreclosure sale.

The FHA and VA both provide alternative, government-backed mortgage insurance. Currently about half of the new, insured mortgage volume nationwide is covered by FHA-VA policies, half by private underwriters.

Private mortgage-insurance policies traditionally have been paid for like this: The home buyer hands over a first-year premium at the settlement table. The charge on a fixed-rate loan might be one-half of 1 percent of the mortgage amount—\$500 on a \$100,000 loan, \$750 on a \$150,000 mortgage.

The problem is that the private mortgage-insurance industry has been losing money by the bucketful. Estimated losses from claims during the past two years exceed \$900 million, according to data from an industry trade group, the Mortgage Insurance Companies of America.

Most of these losses can be traced to a combination of poor underwriting, risky adjustable-rate loans, low premium rates and the economic

crises of the farm-belt and oil-patch states. When purchasers in hard-hit areas lost their jobs in 1982-84, they stopped paying their mortgages. When the mortgage insurers tried to recoup their losses by selling the foreclosed homes, they were stuck. The houses often had declined in cash value by 25 percent to 40 percent.

Rocked by these losses, several major firms have stopped writing new policies. All the insurance firms have toughened restrictions on where they will insure, the type of borrowers they'll underwrite and the types of properties they'll accept. They've also raised their premiums substantially. One industry leader, Mortgage Guaranty Insurance Corp., has boosted its premiums by 50 percent, according to the firm's president, William H. Lacy.

The tougher underwriting standards no longer are limited to economically depressed areas, either. Some high-cost Boston condominiums, for example, recently have been denied coverage on mortgages with 5 percent down payments by insurers who think New England's price escalation is out of hand.

**NEXT:** The FHA and the mortgage-insurance crisis.

COMMUNITY  
OF THE  
AMALGAMATED CLOTHING AND TEXTILE WORKERS UNION  
ON THE  
SENATE BANKING COMMITTEE'S  
OVERSIGHT HEARING ON THE COMMUNITY REINVESTMENT ACT  
MARCH 21 & 22, 1988

We applaud the work of this Committee in examining the use and enforcement of the Community Reinvestment Act. This statute serves as one of the few protections working men and women have to ensure their equal access to credit. All too often, commercial banks draw deposit dollars from poor and working communities only to ignore them when deciding where to lend. The evaporation of consumer credit, redlining, discrimination in home loans and high interest rates on credit cards all disproportionately affect working Americans, including our members.

There is no better example of the need for a stronger C.R.A. in curbing the direction of many commercial banks than the recent application by Continental Illinois Bancorp to purchase Grand Canyon State Bank in Arizona. A.C.T.W.U. has formally protested this merger, which is now before the Federal Reserve Board.

The facts are chilling. The purchase of Grand Canyon State Bank is described by Continental Illinois as part of their strategy to focus consumer services on the rich.

"(Continental's) strategy includes serving the individual market by concentrating primarily on meeting the financing, investment and fiduciary needs of professionals, entrepreneurs, executives and significant private investors... the migration of affluent individuals to the Sunbelt, particularly Florida and Arizona, dictates that (Continental) have a presence in those states in order to maintain personal contacts and provide high quality personal services to those individuals." (Emphasis added.)

(Extracted from Continental's application to the Federal Reserve Bank of Chicago.)

We all remember Continental Illinois for its dramatic bailout by the Federal government in 1984. In a package estimated at \$4.8 billion, United States taxpayers assumed \$2.753 billion in bad loans and a controlling interest in Continental to save what was then the eighth largest bank in the country. Today the F.D.I.C. still owns more than 60% of Continental Illinois.

Despite the benefits of this public purse and without regard for the credit needs of Chicago workers, Continental intends to

pursue the wealthy to the havens in the sunbelt. This brazen disregard of the Community Reinvestment Act is not the sole cause of our concern.

\* According to a bank lending study prepared for a Chicago community group in 1985, Continental had committed only 0.3% of its assets in 1983 to residential lending, and of that money, only 1.7% was loaned in predominantly minority neighborhoods while only 6.6% went to low income neighborhoods.

Since then, Continental's residential lending has lagged behind its competitors, and concentrated on larger loans and in neighborhoods outside the city of Chicago. As an example, the average first mortgage home loan in Chicago in 1985 was \$60,335 while Continental's averaged \$189,000 according to a Woodstock Institute study.

\* Continental's average commercial loan size was also significantly larger than the average business loan in Chicago-- \$1.16 million, compared to \$433,368 according to data filed with the city of Chicago in 1986 and 1987. A review of the Small Business Administration office in Chicago reports that Continental is "very inactive" on small business loans. In three Chicago outlets, Continental is registered as having made two S.B.A. loans since 1984 and only nine S.B.A. loans prior to that (seven of which were originated in 1981).

\* In October of 1987 Continental Illinois announced it would no longer participate in the underwriting of municipal bonds, depriving the city of Chicago of financial support. Continental itself had cited in its C.R.A. statement only one year earlier that its municipal bond underwriting "supported the financial stability of local governmental units..."

\* In late October 1987, Continental announced its intention to sell five banks as part of their efforts to curtail their retail banking operations. This action threatened loss of thousands of jobs, as well as adversely impacting on the community.

While the record of investment in the community appears meager, Continental has pursued a troubling and aggressive strategy into riskier areas of lending.

\* During the market crisis of October 19 & 20, 1987, Continental Illinois' subsidiary, First Options of Chicago, Inc., lost \$90 million, a dramatic figure given that Continental had spent only \$125 million to acquire First Options less than one year earlier.

To prevent the collapse of First Options during the crash, Continental violated banking regulations when it infused \$25 million through Continental's bank subsidiary into First Options.

\* There has been a dramatic outward flow of dollars from Continental. At the beginning of 1987 for example, Continental had \$11.2 billion in total foreign assets but only took in \$8.9 billion in foreign deposits. The placement of more than \$1 billion in new funds in Japanese banks during the course of 1985 represents an enormous transfer of funds to fuel the Asian economy.

\* Continental has pursued fee income through more risky "off balance sheet transactions" like futures contracts, standby letters of credit and foreign exchange purchases, the amount of which increased by 24% to a total of \$27 billion in 1986.

Both the Office of the Comptroller of the Currency and Federal Reserve Board have authority over Continental's C.R.A. posture. While we believe that our protest and these hearings have brought to light many of the problems in this case, public and regulatory attention is the exception in C.R.A. In most communities and towns there is no outside oversight. As a union with members throughout this country, we know the problems of discriminatory lending practices are not isolated to Chicago or Continental.

For more information, contact Bill Patterson (202) 639-7071.



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

May 23, 1988

MARTHA R. SEDER  
MEMBER OF THE BOARD

The Honorable William Proxmire  
Chairman  
Committee on Banking, Housing, and  
Urban Affairs  
United States Senate  
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of March 31 containing written questions in connection with the hearing held on March 23 on the Community Reinvestment Act. I am pleased to enclose my responses to your questions.

I hope this information is useful. Please let me know if I can be of further assistance.

Sincerely,

*Martha R. Seder*

Enclosure



1. CRA requires your agency to assess a lender's performance in meeting local credit needs. What steps do your examiners take as part of the regular CRA examination to determine local credit needs?

A routine part of the Federal Reserve's CRA examination process is what we call "community contacts." That means our examiners go outside the confines of the bank being examined and into the local communities to talk to people - representatives of neighborhood organizations, government officials, businesspeople, merchants and realtors. The aim is to gain a balanced, realistic view of the state of the local economy, and how good a job financial institutions in the area are doing in helping to meet needs for credit. With this information, examiners can more meaningfully assess whether the bank's efforts to ascertain and address community credit needs are on target.

2. Your testimony states that extensions of the public comment period are given when groups can make the case that an extension is necessary. What standards do you use to determine whether or not a group has made the case? How does your agency communicate these standards to the interested community groups?

The Board abides by rules specifying that the public comment period can be extended beyond 30 days only on "a clear showing of" hardship, or "for other meritorious

NEIGHBORHOOD LENDING AGREEMENTS:  
NEGOTIATING AND FINANCING COMMUNITY DEVELOPMENT

Marc A. Weiss and John T. Metzger

With the introduction of land-use regulations in this century, negotiated agreements have become a standard feature of urban development. The primary actors in these negotiations have been real estate developers and public sector regulators [Weiss 1987]. In more recent times, organizations representing neighborhood property owners and residents have also made their voices heard in the decision-making process. However, even in cases where community groups engage in direct bargaining with developers, neighborhood organizations often oppose new development or redevelopment without proposing constructive alternatives. Community involvement in negotiations expressly designed to promote long-term strategies for neighborhood development has not yet become the common pattern.

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This paper was originally presented at the conference, NEGOTIATED DEVELOPMENT -- THE CHALLENGE OF NEW PARTNERSHIPS, sponsored by the Lincoln Institute of Land Policy in Cambridge, Massachusetts on June 6, 1986. The paper was updated in February 1988. The authors are grateful for financial support of their research to the Lincoln Institute of Land Policy; the School of Urban Planning and Policy, University of Illinois at Chicago; and the Center for Neighborhood Development, Cleveland State University. We especially wish to thank Professor Lawrence Suskind of the Massachusetts Institute of Technology and Harvard University, for providing constant encouragement of this project.

Recently a new model of affirmative negotiations was created in the City of Chicago. A key aspect of this approach is that the community groups are acting as spokesmen for real estate developers, sitting at the bargaining table with real estate lenders to negotiate a plan for privately financing community redevelopment of inner-city neighborhoods.

The strategy of negotiated financing for neighborhood revitalization is made possible by a federal law called the Community Reinvestment Act (CRA). The CRA essentially requires legally-chartered financial depository institutions to loan money in the geographic areas from which they draw their deposits. The CRA and its companion legislation, the Home Mortgage Disclosure Act (HMDA), were passed by Congress in the mid-1970s as a response to the "redlining" issue, in which various community groups documented patterns of disinvestment by lending institutions in certain central city neighborhoods. The HMDA requires public disclosure of lending patterns so that the performance of banks, savings institutions, and their mortgage banking subsidiaries can be evaluated by community groups and public officials. Citizens can obtain access to HMDA data and utilize it to challenge an institutional lender's CRA record. A CRA challenge can cause federal regulators to deny permission for lenders to add new branches or to merge with or acquire other institutions.

These two models have been used by the Chicago Reinvestment Alliance, a broad coalition of community organizations, neighborhood development groups, and citywide development networks. In the spring

of 1984, the Alliance successfully negotiated neighborhood lending agreements with three of Chicago's four largest banks. First National, Marrie, and Northern Trust Banks agreed to create an aggregate, five-year lending pool of \$173 million for housing, commercial, and industrial development in inner-city Chicago neighborhoods. During 1986 the Alliance negotiated a \$20 million neighborhood lending agreement with Chicago's other large bank, Continental Illinois. The Chicago case is perhaps the most significant community/bank partnership of its kind in the country, due to the size and scope of the agreements -- which include increased commitments from each bank foundation for community development -- as well as the role played by community-based organizations in loan packaging and program review [Bailey 1985].

This paper will proceed in three parts. First, the model for negotiating inner-city neighborhood development will be outlined to illustrate the key components of the bargaining process. Second, the Chicago experience will be examined by tracing the negotiations with the banks, the programs created, and the results, in order to reveal the dynamics of the model. Finally, the Chicago case will be placed in a larger context of experiences in other cities, to determine its relevance, applicability, and potential as a model for negotiated urban development.

#### THE MODEL

The most distinctive feature of this model of negotiated urban development is that it is based primarily on private initiative -- no government agency formulates or implements a program for neighborhood reinvestment. Instead, strategies are created and managed by community organizations in tandem with financial institutions. Government acts: 1) as a formal rule maker, setting the context for negotiations through enforcement of the Community Reinvestment Act; 2) as a contributor to fact-finding, through enforcement of the Home Mortgage Disclosure Act and, in the case of Chicago, the city's own more extensive ordinance that also requires disclosure of savings deposits and commercial lending patterns; 3) as an informal broker in negotiations, as was the case with the Mayor of Chicago; and 4) as a facilitator of the development process, through grant and loan programs, planning assistance, infrastructure improvement, and other forms of subsidy. The interaction of the three sectors -- citizen groups, government, and lenders -- creates a "private-public-private" decision-making process.

The two federal financial regulatory laws play a crucial role in this model. Political pressure in response to "redlining" and inner-city disinvestment from neighborhood coalitions in Chicago and across the country during the 1970s resulted in the enactment of HMDA and CRA [Raperstok and Cincotta 1976; Urban-Suburban Investment Study Group 1975]. The Home Mortgage Disclosure Act of 1975 requires banks and savings institutions and their mortgage banking subsidiaries, as well as credit unions and all other depository institutions, to document

the number and dollar amount of five residential lending categories -- government-insured mortgage loans (FHA, Veterans Administration, or Farmers Home Administration), conventional mortgage loans, home improvement loans, non-occupant mortgage loans, and mortgage loans on multifamily dwellings. With the exception of the latter, the disclosure categories apply to mortgage loans on properties with one to four units.<sup>1</sup>

The Community Reinvestment Act of 1977 requires banks and savings and loans to affirmatively invest in and meet the credit needs of communities they are chartered to serve. Under the law, a financial institution must annually adopt a CRA statement that outlines its community lending record, and must post a CRA notice on its premises which publicizes both the availability of its CRA statement and the public's opportunity to submit comments on the institution's performance in meeting local credit needs. The bank's CRA statement and all public comments on its lending performance are filed with federal regulatory agencies, who oversee the institution's compliance with the legislation.<sup>2</sup>

The impetus for enforcement is vested in the public's power to challenge merger and branch applications made to federal regulators, on the grounds that the applying institution has failed to meet its CRA obligations. Despite the initial concerns over forced credit allocation, the regulations have been interpreted to place the ultimate responsibility on the challengers, usually a community group, encouraging them to use the challenge threat in negotiating lending

agreements [Canner 1982; Eisman 1982; National Training and Information Center 1979a; National Economic Development and Law Center 1979]. When the CRA was passed, the U.S. Department of Housing and Urban Development (HUD) foresaw this, and issued contracts to community-based organizations to develop manuals for using HUD's and CRA in implementing neighborhood reinvestment strategies [National Training and Information Center 1979b; U.S. Department of Housing and Urban Development 1979a, 1979b, 1979c].

The CRA was introduced in March 1977 by Senator William Proxmire of Wisconsin, the chairman of the Senate Committee on Banking, Housing and Urban Affairs and a key congressional supporter of HUD in 1975. His bill was based on two assumptions -- that financial institutions, rather than the public sector, should be the primary suppliers of capital for housing and economic development, and that public operating charters granted to private lenders should include a responsibility for community lending. The Community Reinvestment Act authorizes federal regulators to review the community lending policies of financial institutions, and consider public challenges to a lender's service record in meeting local credit needs when deciding upon applications for branches or mergers. Essentially, the act utilizes federal regulatory powers over financial market structure to encourage favorable lending policies [U.S. Senate Committee 1977].

The delegation of enforcement responsibilities among the various federal financial regulatory agencies is outlined in Figure 1. While few merger and branch applications have been denied by the federal

government based on a CRA challenge, the actual challenge, or threat of one, coupled with HMDA lending data and the bank's CRA statement, has often been enough to initiate reinvestment loans for community development projects in disinvested areas. Since its enactment, the CRA has been used nationwide by community groups to negotiate and implement neighborhood lending agreements with local banks (Cannar 1982; National Training and Information Center 1979a; National Economic Development and Law Center 1979).

FIGURE 1. Enforcement Responsibilities for the Home Mortgage Disclosure Act (HMDA) and the Community Reinvestment Act (CRA)

| Type of Institution                                                                           | Regulatory Agency                                         |
|-----------------------------------------------------------------------------------------------|-----------------------------------------------------------|
| National bank                                                                                 | Comptroller of the Currency                               |
| State bank, member of Federal Reserve Board                                                   | Federal Reserve Board                                     |
| State bank, federally insured, but not a member of Federal Reserve Board; Mutual savings bank | Federal Deposit Insurance Corporation                     |
| Federal Savings and Loan; State Savings and Loan, federally insured                           | Federal Home Loan Bank Board                              |
| National Credit Union; State Credit Union                                                     | Administrator of the National Credit Union Administration |
| All other depository institutions                                                             | Federal Deposit Insurance Corporation                     |

These experiences in cities across the country indicate the replicability and visibility of the described model of negotiated urban development. The model is important for two reasons. First, it outlines a role for the public sector as a broker between citizen coalitions and private lenders, by informally and formally -- through the CRA and HMDA -- providing tools for information and negotiation that stabilize and equalize the bases of power in the bargaining process.

Second, it illustrates the growing power of community-based organizations in negotiated urban development. Neighborhood organizations play a vital role in many urban communities, by organizing residents, providing services, and undertaking actual development projects on their own.<sup>5</sup> These groups have grown in sophistication, serving as a base for community action and development that can be more accountable and flexible in meeting local needs than exclusively governmental efforts (Weiss and Metzger 1987; Vidal et al. 1986; Mayer 1984; Mayer and Blake 1981; Downs 1981; Cunningham and Kotler 1983).

The model reveals the possibilities of a negotiated public-private partnership that utilizes both the growing expertise of neighborhood-based organizations and the previously untapped resources of local financial institutions. The effectiveness of the model depends on the presence of: 1) a context of enforceable rules, through the CRA framework; 2) trained professionals with research, development, and negotiating skills; 3) widely disseminated financial information and policy education; 4) actively mobilized community



groups; and 3) public support to legitimize the brokering process, and provide a basis for programs and subsidies that facilitate the success of neighborhood lending agreements.

Opportunities to use this model of negotiated urban development are spreading rapidly within the current climate of a deregulated banking industry. Financial deregulation has increased the competition for banking services, and in response many institutions have adopted interstate and national expansion strategies for acquiring and merging with other financial entities [Florida 1986; Cooper and Fraser 1984]. As a result, neighborhood groups are being presented with opportunities to negotiate lending agreements with financial institutions, using the leverage of either the CRA or new interstate banking legislation to monitor and respond to changes in financial market structure [Rieschnick 1986; Bradford and Scharsten 1985]. In this context, negotiated development can emerge to play a vital role, by convening a "private-public-private" decision-making process to resolve conflicts over urban development and finance arising from the changing environment of the financial services industry.

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A brief extension would be in order, for example, where the application has not been promptly made available for inspection, or there has not been adequate public notice of the application. But it would not be granted if the commenter simply wants more time to collect additional information, or to conduct further negotiations with the bank.

Depending on the type of application, notice is published in newspapers serving the same locale as the bank or banks that are party to the application, as well as in the Federal Register. Those notices state the duration of the comment period and direct questions about the application process to Reserve Banks. The Reserve Banks, and especially their Community Affairs staff, have made it known in their work with community groups that extensions are warranted under these very narrow circumstances, and are the exception rather than the rule.

3. CRA examination procedures provide examiners with general descriptions of the attributes that warrant an institution's receiving a particular rating. What quantitative measures do examiners use to determine which rating an institution should receive? How do you assure that these standards are applied consistently?

A uniform, comprehensive rating system for evaluating bank CRA performance was developed by federal regulatory agencies in 1979, setting out 5 performance categories based

on the assessment factors contained in the CRA's implementing regulation. To maintain consistency in applying this system, our examiners receive extensive training in the interagency-approved examination procedures, which are set out in our Compliance Handbook. We also regularly review examination reports, on a sample basis, here in Washington to ensure that these procedures have been closely followed.

The standards contained in the rating system are primarily qualitative in nature, rather than quantitative. The rating system gives the examiner a description of the type - but not specific amount - of activities institutions should be engaged in to merit ratings on the 1 through 5 scale within each of the performance categories.

Our examiners do utilize techniques when conducting examinations that lead to quantitative, substantive information about the bank's performance. For instance, as appropriate, examiners may look at HMDA data to determine the extent of the bank's involvement in providing housing-related credit, or the number and size of its participations in downtown revitalization projects in order to gauge its support for community development efforts. The rating criteria, however, are not quantitative, largely because they must apply to all banks in all communities.

The examiner's job is to assess the bank's overall performance in helping meet local credit needs, consistent with CRA's broad mandate. That job especially requires

taking into account the bank's financial condition and size, legal impediments, and the prevailing local economy, including the competitive environment in which it operates. The nature of the community itself - whether predominately urban or rural, and many other special characteristics - will have a significant bearing on how a bank addresses its obligations. Given these factors, general quantitative measures for performance designed to be used in all banks are not particularly useful.

4. In your testimony you indicate that the geographic distribution of commercial and small business lending is an important aspect of evaluating an institution's CRA performance. How do your examiners determine such distribution?

A major emphasis in examining for CRA is to try to ensure that the institution is serving the community where it is located -- primarily, through the extension of credit. When it comes to business loans, our examiners' initial concern is not so much to pin-point the exact location of each of those loans, but rather to determine whether the bank being examined is actually making small business loans within the boundaries of the defined community. They may do this by checking loan files and comparing addresses of business loan recipients with the delineated community map. They may also ask our "community contacts" outside the bank for their views on how well the bank's lending program are meeting



credit needs of the business community. For small and rural banks (which include most of those supervised by the Federal Reserve), it is often relatively easy to identify the location of local businesses financed by the bank being examined.

In addition to this overview of a bank's loan distribution, a more complete review of lending patterns may be undertaken when the examiners check for compliance with other laws governing the extension of credit. The unique circumstances of each case, however, will determine to what extent our examiners would focus on the precise geographic distribution of business loans. Using examination procedures for the Equal Credit Opportunity Act (ECOA), examiners employ random sampling and comparison techniques to conduct a preliminary review of consumer, as well as business, loans in the bank's portfolio. If the preliminary review indicates that there may be an improper distribution of the loans, the examiner should undertake a more detailed review. These steps could entail expanded sampling, interviewing loan personnel or outside sources in greater depth, and, in some cases, geocoding actual loans.

I would also point out that, for purposes of CRA, the nature and degree of business lending which the bank has been willing to undertake is often as important as the precise distribution. For example, we are interested in knowing whether the bank has participated in government-insured, guaranteed, or subsidized loan programs,

including the SBA loan guaranty programs and similar state or locally-sponsored programs. In an urban setting, we would also consider favorably a bank's support for a Minority Enterprise Small Business Investment Corporation (MESBIC) or Small Business Investment Corporation (SBIC).

5. You stated that you prefer to make conditional approvals, with commitments to improve performance, to outright denials, when agencies have weak CRA performance ratings. What procedures do you have in place to monitor fulfillment of the conditions you set? What action has your agency taken when the institution has failed to meet its pledge? Please provide examples of such actions.

There are various ways we monitor a bank's performance of its commitments to the Board, and our course of action will very much depend on the degree of oversight warranted by each particular situation. Frequently, the Board's order in the particular case calls upon the applicant to submit regular progress reports to the Reserve Bank, which then follows-up with appropriate measures. On the other hand, fulfillment of a relatively simple commitment could be determined by telephone or through correspondence; the implementation of a new CRA-related lending or training program, however, might well involve more extensive, ongoing review by the Reserve Bank. Future CRA examinations provide continuing "check" on the applicant's adherence to commitments.

These are carried out by Federal Reserve examiners for state member banks.

The Board reassesses an institution's CRA performance each time it submits a covered application. This provides strong incentive for applicants to comply with commitments made to the Board, since they know their record of doing so will be considered as part of future applications.

As a measure of "last resort," federal law gives the gives the Board authority to pursue cease-and-desist proceedings against a bank - or its directors and officers - for violating any condition imposed in writing as a condition of granting an application. Less stringent enforcement measures, such as Memoranda of Understanding or Written Agreements, could also be used. To my knowledge there have been no cases in which an applicant has ultimately failed to address commitments to the Board in a way that was deemed satisfactory.

6. What is your agency's policy regarding settlements between applicants and community groups...do you monitor actions under such agreements, and do you factor in the follow through in subsequent CRA ratings?

We very much encourage banks and community groups to talk with each other and, as much as possible, narrow their differences. However, we do not believe it is our plan to push for formal agreements, which we regard as private matters between the applicant and the protestant.

As such, they are not subject to enforcement by the Federal Reserve System - unlike the commitments which are made to the Board. I think it is important to make this distinction clear, since by becoming more directly involved in private agreements we may be seen as supporting the allocation of credit and, perhaps, as favoring one particular community group over other worthy ones.

On subsequent CRA examinations, we would certainly take note of any bank activities resulting from these agreements, which fall in line with the CRA performance categories.

Federal Home Loan Bank Board  
OFFICE OF THE CHAIRMAN

M. DANNY WALL, Chairman



1700 G Street, N.W.  
Washington, D.C. 20552

Federal Home Loan Bank System  
Federal Home Loan Mortgage Corporation  
Federal Savings and Loan Insurance Corporation

25 MAY 1988

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*CRA*  
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The Honorable William Proxmire  
Chairman  
Committee on Banking, Housing, and  
Urban Affairs  
United States Senate  
Washington, D.C. 20510-6075

Dear Mr. Chairman:

In accordance with your request, I am attaching a document responding to the questions you raised for the written record of the Community Reinvestment Act Hearing.

Please let us know if we can provide additional information.

Sincerely,

*M. Danny Wall*  
M. Danny Wall

Attachment



Responses to Senator Proxmire's Letter of March 31, 1988

Questions 1 and 2: CRA requires your agency to assess a lender's performance in meeting local credit needs. What steps do your examiners take as part of the regular CRA examination to determine local credit needs? Do your examination procedures require examiners to solicit the views of community groups and others, as part of the CRA examination process? If not, how do you assess local credit needs in order to evaluate how well an institution is serving these needs?

Federal Home Loan Bank examiners are directed to use CRA examination procedures that recognize that an assessment of an institution's CRA performance record in helping to meet the credit needs of a local community is a judgmental process requiring a balanced viewpoint. The procedures are designed to ensure that information from both the institution and the community are objectively reviewed and evaluated.

Specifically, the examiner is charged with evaluating the institution's efforts at ascertaining community credit needs (12 C.F.R. 563e.7). Furthermore, the CRA examination procedures provide the flexibility to permit the examiner to interview real estate brokers, community action groups, religious or political leaders, merchant's organizations, block clubs, neighborhood groups and coalitions, local civil rights, consumer, minority, and non-English speaking groups, housing counseling service centers, community development corporations, nonprofit housing development corporations, and local development corporations. These interviews enable the examiner to gain a better perspective of the credit needs of the local community as well as an understanding of the extent to which the institution has endeavored to ascertain and meet those credit needs.

Unfortunately, primarily due to resource and time constraints, examiners have not, in recent years, conducted community interviews to any significant degree. It is our intention to explore routinizing this procedure to a much greater extent in the future.

**Question 3:** CRA examination procedures provide examiners with general descriptions of the attributes that warrant an institution's receiving a particular rating. What quantitative measures do examiners use to determine which rating an institution should receive? How do you assure that these standards are applied consistently?

The examiner's rating of an institution is based on an evaluation of the performance assessment factors in the act and its implementing regulation. Neither the act nor the regulation proscribe any quantitative measurement criteria for evaluative purposes, and therefore, our examiners do not employ any quantitative measurements in assigning a CRA rating to an institution. Enclosed for your information is a copy of our AB-35 which identifies the standards to be used in assigning CRA ratings.

**Question 4:** In your testimony you indicate that the geographic distribution of commercial and small business lending is an important aspect of evaluating an institution's CRA performance. How do your examiners determine such distribution?

Our examiners are directed to make an assessment of the geographic distribution of an institution's credit extensions pursuant to one of the CRA assessment factors so as to identify areas where little or no lending is taking place and for which management could give no sound justification for the lack of lending. This assessment would include commercial and small business lending activity. Traditionally, our institutions have been very involved in housing-related financing and do not make

many commercial or small business loans. As a matter of fact, only two percent of our total institution assets are in commercial loans.

Question 5: You stated that you prefer to make conditional approvals, with commitments to improve performance, to outright denials, when agencies have weak CRA performance ratings. What procedures do you have in place to monitor fulfillment of the conditions you set? What action has your agency taken when the institution has failed to meet its pledge? Please provide specific examples of such actions.

-CRA conditions attached to approvals should be monitored by the Federal Home Loan Banks just as any other conditions, such as those relating to safety and soundness, should be monitored. This monitoring should take place through the normal examination process and through supervisory reviews of institution responses to reporting requirements frequently imposed as part of a condition. If an institution does not fulfill the terms of a condition, the Bank Board can invoke its cease and desist authority, if necessary, to compel the correction of any deficiencies. As part of our review of the compliance program, we will be looking to see whether the monitoring of CRA conditions should be strengthened.

Question 6: You have indicated that the Board has delegated responsibility for CRA examinations and enforcement to the Federal Home Loan Bank System. Since the system is owned and is largely controlled by the member thrifts, how do you assure that CRA enforcement is performed adequately and consistently? What procedures are employed to assure consistent performance?

As I pointed out in my remarks during the hearings, the Division of Compliance Programs in the Office of Regulatory Programs, Oversight and Supervision (ORPOS), was recently established for the primary purpose of developing national standards and

procedures for the conduct of examinations involving, among other things, traditional consumer protection laws and regulations, including CRA. We have great expectations for this new program and believe it can fill a coordination gap that we have had in this area over the years. We are confident that, given the proper tools and training, the Federal Home Loan Banks will enforce CRA appropriately.

To assure consistency among the districts, ORPOS has established a "peer review" program, which, in a nutshell, is a program whereby quality assurance evaluations are conducted of the examination and supervision functions of each Federal Home Loan Bank on a periodic basis. Once the foundations for our compliance program are footed and the program is operational, we intend to include compliance activities in the scope of each "peer review."

Furthermore, the Division of Compliance Programs within ORPOS is in the process of enhancing its management information system with an eye towards developing a better database for the collection and processing of examination statistics on the consumer affairs laws and regulations including CRA. These enhancements would provide for a much better monitoring system than what currently exists and enable us to spot trends and any apparent weaknesses in the Banks' consumer affairs examination efforts.

Question 7: The Federal Reserve Board has established specialized examiners with a separate career ladder, and maintains separate regional offices for CRA enforcement. Are you considering adopting such a system? If not, why not?

We recognize that there are many positive advantages to having separate examination personnel conducting CRA and consumer affairs examinations. We are looking at the programs used by the other agencies, including the Federal Reserve Board, in developing our own approach. The Federal Reserve's program is well-respected among the regulatory agencies and may very well serve as a

benchmark for us. Certainly, one of the alternatives we will explore is the feasibility of establishing a separate examination program for this area.

Our new Division of Compliance Programs within ORPOS has been charged with developing a national program for legislated areas that address the public interest; specifically consumer affairs, fiduciary activities, and legislated areas related to the public interest such as the Bank Secrecy Act. This unit will be responsible for producing manuals and special memoranda to examiners and supervisors for these areas. Additionally, this unit will work with our Bank System Office of Education to develop national training standards for these areas. It will also house experts that, at the request of a District Bank, will be available for support during complex examinations.



## Comment - re: Senator Graham's question

Using Senator Graham's terms, the Federal Home Loan Bank System would view CRA "performance" of an institution as more important than the CRA "process." The technical aspects of the regulation, i.e., whether there are some errors on the CRA statement or whether the Board has approved the CRA statement on a timely basis each year, while important, are not, in our review, as important as the institution's actual practices in helping to meet the credit needs of its community. In that connection, we believe it is appropriate to evaluate an institution's activities against each of the twelve performance factors listed in the CRA regulations. If during an examination the examiner finds that an institution seems to be granting a disproportionately low amount of credit in an area where credit demands are remaining unfilled, (e.g., factors e, h, i and j of Section 543e.7) the examiner should point this out to the institution and encourage the institution to do more in meeting those unfulfilled credit needs. We would, however, stop short from recommending or requiring specific numbers of loans or specific dollar amounts since we believe that involves credit allocation and is appropriately within the realm of management's, and not the regulator's, responsibility. As I indicated in my earlier comments, I believe that our examiners could do more in involving the community in the examination process, particularly by making contacts to determine the degree to which the community views credit needs as being unmet and whether institutions could do more to fulfill those credit needs.

The following are the total hours spent by Federal Home Loan Bank System examiners on CRA for the years 1983-87. These hours are solely examination hours and do not include additional time spent on CRA matters by supervisory personnel, such as review of examination reports and communication with institutions and others on CRA matters. This supervisory time is not recorded and, therefore, cannot be included.

| <u>Year</u> | <u>Hours</u> |
|-------------|--------------|
| 1983        | 11326        |
| 1984        | 6578         |
| 1985        | 4313         |
| 1986        | 10486        |
| 1987        | 15283        |

The increase in time spent in 1986 and 1987 reflects the fact that our examination staff doubled in the past two years, allowing us to spend more time on CRA and other matters.



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, D.C. 20410-8000

April 15, 1988

OFFICE OF THE ASSISTANT SECRETARY FOR  
HOUSING-FEDERAL HOUSING COMMISSIONER

Honorable William Proxmire  
Chairman, Senate Committee  
on Banking, Housing and  
Urban Affairs  
Washington, DC 20510-6075

Dear Senator Proxmire:

I am writing in response to your letter of March 24, 1988, in which you ask HUD to respond to several issues raised during recent hearings on the Community Reinvestment Act. Specifically, a representative of the private mortgage insurance industry argued that FHA has failed in its basic mission to assist moderate-income home buyers. The witness was also sharply critical of Congress' recent decision to raise FHA's maximum mortgage limits in high cost areas. He suggested instead the need to restrict FHA in order to redirect our agency toward assisting those not served by the private sector.

At the outset, let me note that I believe that all of us in the mortgage insurance business--both in government and the private sector--can and should do more to expand the opportunities of modest-income home buyers. Private insurers can legitimately point to the successes their companies have had in assisting these families (e.g., in the early eighties), just as FHA can be proud of the successes we have had--both historically over the 54 years of our existence and particularly at present.

A wide variety of factors have led to the sharp reduction in the availability of conventional low downpayment loans since 1984. To some extent, the actions of lenders, insurers, rating agencies and the secondary market merely reflect an economic environment that is sharply different than in prior years, and the need to preserve financial stability in the lending and insuring industries. Nonetheless, we still need to assure that moderate-income families have access to mortgage loans, and I am proud of the role that FHA has played in maintaining that access.

During 1986 and 1987, FHA insured roughly 2.3 million home loans. By comparison, private mortgage insurers (MIs) insured roughly 1.1 million loans during the same period--of which only 600,000 loans would have been within the FHA mortgage limits during this two year period. Applying the MICA report percentage

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for 1986 (the last year covered by the study), we estimate that between 1986-87 FHA insured 1.3 million loans to families earning less than \$40,000--versus only 300,000 for MIs. Similarly, during this period, FHA insured 1.1 million loans under \$60,000--versus only 400,000 for MIs.

Yet while FHA can be proud of our achievements, we can't afford to be complacent. As recent studies have amply demonstrated, families of modest means face severe difficulty in qualifying for home ownership--despite the significant gains in affordability that have occurred in recent years. And while FHA has a particular mandate to serve these families, the private sector has a responsibility to do what it can as well.

In this regard, I want to commend you for holding hearings on the CRA at this time. The financial distress that many lenders and insurers face is indeed real, but this must not become an excuse for failing to assure that all Americans have a fair opportunity to obtain credit. You correctly noted that CRA lending can be profitable under the proper conditions, and we need to do more to spread this message.

The essence of a successful CRA effort is the combined efforts of lenders, community groups, effective screening and counseling programs, working in concert with insurers who are willing to be flexible and responsive to the unique circumstances of each program. Obviously, where local CRA programs are doing a poor job in originating or servicing loans, insurance alone will not make their programs successful. Yet even the best CRA program will fail if mortgage insurance is unavailable. Low downpayment loans are crucial if we are to help moderate-income buyers, and these loans need some form of insurance coverage.

For our part, FHA needs to do more to make CRA lenders aware of our programs and to help them learn how to qualify for FHA approval. I recently travelled to Philadelphia to meet with the participants of their CRA program, to learn first hand what we needed to do in order to be more responsive. As a result of our meeting, our regional staff will be expanding their outreach and training programs to focus more on depository lenders.

We plan to work with the Federal Reserve Board to identify other areas of the country that need additional mortgage insurance coverage and offer our assistance. I see our role as helping to strengthen and sustain successful CRA programs, and then building upon these models to the point that we encourage greater private sector participation throughout the nation.

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Yet, as firmly as I support the expansion of FHA in the CRA effort, I can not agree with MICA's argument that FHA must do less in assisting other borrowers in order to do more in this area. And I strongly disagree with the argument that the recent minor adjustment to FHA's mortgage limits in high cost areas will cause us to neglect borrowers of modest means. Finally, I believe that much of MICA's concerns about lenders who discriminate against borrowers with low mortgage amounts has been dealt with strongly and directly via Section 419 of the Housing and Community Development Act of 1987. I support this provision, and we intend to assure that lenders comply with the law.

As you know, Congress established the current system for setting FHA mortgage limits in 1980. For most areas of the country, the maximum set then--and still in effect now--was \$67,500. However, recognizing that housing costs vary tremendously throughout the country, Congress also authorized HUD to establish higher limits in certain markets, calculated at 95 percent of the area's median home sales price. Even under this alternative high-cost formula, Congress set an absolute ceiling for single family mortgages in 1980 at \$90,000. Since then, home prices in a number of areas have risen sharply, and the latest legislation raises the absolute ceiling to \$101,250--but again, only in areas where the price of a typical home already exceeds this amount.

In these areas, the cost of buying a home is so high that many families face difficulty qualifying for mortgage loans even with two incomes. FHA has traditionally used more liberal underwriting standards than conventional lenders, and this flexibility gives us the ability to help families in high cost housing markets--just as it helps us meet the needs of lower-income families buying in the inner-city.

The problems faced by a two-income family trying to buy a home in San Francisco or Washington, D.C. are immensely different than those faced by a lower-income family buying in inner-city Philadelphia--but in one key respect they are similar. In each instance, the borrower will have to spend a considerable portion of his/her income to be able to make the mortgage payments. And the private sector has increasingly been reluctant to make or insure these so-called "high ratio" loans--regardless of whether the cause is low income, high housing costs or a combination of both.

In my opinion, it would be tragic if we were to adopt an approach that pitted one group of struggling home buyers against another--especially when FHA has the unique ability to serve each. Ultimately, I see our mission to be one of assuring that all Americans have access to mortgage loans. Especially in light of the recent tightening of underwriting by the private sector, we now have an even greater responsibility to ensure that FHA is able to handle cases that do not meet conventional standards.

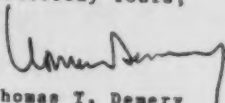


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I see little justification in ignoring the needs of families trying to buy homes in high cost areas merely in order to improve our performance in inner-city lending. We can--and must--do more to support lending to families at the margin. But it would be seriously wrong to conclude that only those families need FHA. I look forward to a time when a revived private mortgage insurance industry expands its performance and aggressively competes with us across the income spectrum (as they did prior to 1986). But FHA's basic role as a support and backstop will always be needed--and in current market conditions, it's usefulness is readily apparent.

Again, I want to thank you for providing us with this opportunity to comment on these issues.

Sincerely Yours,



Thomas T. Demery  
Assistant Secretary for  
Housing--FHA Commissioner



## Woodstock Institute

53 West Jackson Boulevard, Suite 304, Chicago, Illinois 60604, (312) 427-8070

Elisabeth Ravers  
President  
Jean Pogge  
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Vice President

April 22, 1988

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Senator William Proxmire  
Chairman  
Committee on Banking, Housing, and  
Urban Affairs  
Washington, DC 20510-6075

Dear Senator Proxmire:

Thank you very much for holding hearings on the Community Reinvestment Act, and for inviting the Woodstock Institute to provide testimony. I am happy to provide a written response to the question that you posed to me in the letter which I received on April 11.

**Question:** Bankers say that they don't make loans in certain areas because there is no demand. Community groups say the problem is on the supply side. What do you think the major obstacles are in getting supply and demand for loans in balance...are there obstacles in the way business is done by realtors? lenders? mortgage insurers? secondary market brokers?

**Response: Bank Marketing.** Banking, like many other industries, recognizes the need to create demand for its products. Advertisements are placed in local newspapers, radio and television stations, loan officers regularly call on potential and current customers to strengthen business relationships, and the biggest and most lucrative customers are provided with special services and favorable rates. However, these marketing efforts rarely extend to modest income, older and inner city communities. There are a number of reasons why this may be the case:

- 1) Banks traditionally did little marketing. However, as the banking industry has become more competitive, the need to expand such efforts has become evident to most financial

Senator William Proxmire  
 Committee on Banking, Housing, and Urban Affairs  
 April 22, 1988  
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institutions. In so doing, marketing programs were targeted to the most affluent parts of the community where the profits were expected to be greatest.

- 2) For both residential and commercial lending, larger loans provide more profit for less work. A home mortgage loan for \$150,000 takes a similar level of effort as one for \$30,000, but the profit is five times as great;
- 3) There is sometimes the perception, often inaccurate, that people in older, minority or inner-city communities are all poor or unemployed, and are therefore unlikely to meet bank underwriting standards or to be profitable customers for other bank products. Two examples highlight the problem: a Woodstock Institute study of housing lending in the Washington, D.C. metropolitan area found that lending in the suburbs was statistically most strongly related to income, which is to be expected--the more money a family makes the larger loan it is able to repay. By contrast, in the District of Columbia, the strongest predictor of lending was race, showing that perception of risk did not conform to the most important borrower characteristic.

A second study of the customers of a major Chicago bank in 1981 refutes the perception that minority and low-income communities do not represent deposit customers for money center financial institutions. During that year, for every \$100 in deposits the bank received from black neighborhoods, only 60 cents in mortgage loans were made; for every \$100 collected in deposits from hispanic neighborhoods only 40 cents in mortgage loans were made.

- 4) There is a perception by bankers, realtors and others that newer is better. This is of particular concern in commercial and industrial lending, where loans are readily available for purchase and development of new facilities in the suburbs, but more difficult to obtain for expansion or rehabilitation of older, in-city industrial buildings.

While these factors may help to explain lackluster or nonexistent marketing to older, minority, and urban parts of a financial institutions service area, they do not excuse it. More active and aggressive marketing has been shown to be an effective way to help balance the supply and demand for loans.

**Secondary market.** Over the last ten years, the secondary market has made housing credit more available than ever before. Few financial institutions continue to originate large numbers of mortgage loans for their own

Senator William Proxmire  
 Committee on Banking, Housing, and Urban Affairs  
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 Page 3

portfolios. This has had both positive and negative effects on meeting the credit needs of local communities. The benefit has been the widescale availability of home mortgage money. The cost has been the loss of flexibility to the local lender. The standards set by the secondary market have now become the underwriting guidelines for most lending. This has presented problems for communities where modest incomes make it difficult to accumulate a 20% downpayment; lack of recent real estate activity makes it difficult to appraise properties on comparables; housing prices are below standardized minimum loan amounts; housing stock is old and in need of repair; and housing stock is unusual—for example, mixed-use buildings—and therefore does not conform to the suburban ideal, new housing for the typical affluent family.

In the past, a local lender who knew his community and his borrowers would make decisions based on his judgement about whether or not the loan would be repaid. Now, due to the secondary market, the judgement must be made as to whether the loan can be sold to investors.

**Mortgage Insurers.** Mortgage insurance has been a useful tool in enabling families who cannot accumulate a 20% downpayment to purchase a home. With soaring housing prices in many parts of the country, a large downpayment can take so long to save that homes that were once affordable can no longer be purchased by modest income people. However, mortgage insurance adds an additional underwriting process to that already imposed by the lenders and secondary market, and this process has become increasingly risk averse.

Due to losses in recent years, mortgage insurance customers who have only 5-10% downpayments are being subjected to greater scrutiny than those with larger downpayments. This is in spite of the fact that the mortgage insurance premium is designed to pay for the increased risk that a less than 20% downpayment presents. Factors that are subjected to greater scrutiny for those with lower downpayments are breaks in employment history, credit records with even the most minor problems, purchase of properties needing repair or rehabilitation, older properties, and properties in neighborhoods with few comparables. This is especially problematic because the families that need mortgage insurance are generally those who are only able to purchase homes in fair to good shape in older neighborhoods. Many of these same families, especially those located in the industrial rust belts, have experienced a period of unemployment which hurts both their employment and credit histories.

**Realtors.** Realtors are generally the first point of contact between borrower and lender, and thus play an important role in educating the buyer as to what type of financing is available, and from which lenders.

Senator William Proxmire  
Committee on Banking, Housing, and Urban Affairs  
April 22, 1988  
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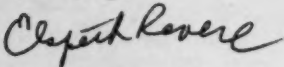
Realtors often have well-formed opinions as to which financial institutions lend in particular communities and for what types of properties and borrowers. They may also reflect their own opinions, for both housing and commercial/industrial real estate purchases, as to desirable locations and relative worth of properties under consideration.

Because realtors often are the ones with the best knowledge of local lending conditions, it is important that they be the first stop for financial institution marketing efforts. A more difficult obstacle to overcome is realtor perception of the relatively lower value of in-city and older communities.

In conclusion, I would reiterate that demand occurs when a product is known to be available. The financial institutions have an obligation to create markets in all parts of their service area, even though some are viewed as less profitable than others. It is also important that the secondary market reflect the range of local conditions and the sound loans that they represent, and that mortgage insurance fairly assess customers with both larger and smaller downpayments.

Thank you for the opportunity to respond to this question. I would be happy to provide any additional information that you need. And once again thank you for your long-term and effective leadership on the reinvestment issue. The impacts of the Community Reinvestment Act, in channeling billions of dollars into local communities and changing the behavior of financial institutions is finally becoming recognized. All of us who work with the CRA are grateful to you for making this important tool the law of the land.

Sincerely,



Elspeth Revere  
President





May 9, 1988

Senator William Proxmire, Chairman  
Committee on Banking, Housing and Urban Affairs  
United States Senate  
Washington, DC 20510

Dear Senator Proxmire:

Thank you for seeking out ACORN's views on the implementation and enforcement of the Community Reinvestment Act of 1977. Enclosed are our responses to questions you directed to us in a letter of March 31, 1988.

We look forward to continuing to work with the Senate Banking Committee on these issues which are of such importance to all low and moderate income Americans.

Sincerely,

Mildred Brown  
President

**Association of Community Organizations for Reform Now**

Organizing and Support Center: 401 Howard Street, New Orleans, Louisiana 70130 (504) 523-1691  
Home Offices: 523 W. 15th Street, Little Rock, Arkansas 72202 (501) 376-7151  
National Office: 522 8th St., S.E., Washington, D.C. 20003 (202) 547-9292

May 9, 1988

To: Senator William Proxmire, Chairman  
The Committee on Banking, Housing and Urban Affairs  
United States Senate

FROM: Mildred Brown, President  
ACORN - The Association of Community Organizations for Reform Now

RE: Responses to questions in March 31, 1988 letter.

Q1. Using the traditional A-B-C-D-F grading system, how would you grade each of the regulators?  
Please include your reasons for giving the specific grade.

A1. The Federal Deposit Insurance Corporation (FDIC) and the Federal Home Loan Bank Board (FHLBB) each get a grade of "F". On their own admission these agencies concede that they do not enforce the Community Reinvestment Act for the financial institutions they regulate.

The Office of the Comptroller of the Currency (OCC) receives a grade of "D" from ACORN. The OCC regulates the biggest banks, the flagships of the bank holding companies which are most heavily involved in expansion. Most of the banks that we have filed CRA challenges against over the past three years have been regulated by the OCC. ACORN has volumes of evidence that these banks violate the Community Reinvestment Act. If a grassroots organization of low and moderate income people, working in a short time frame with access to only a fraction of the data can catch these banks breaking the law, why can't the OCC?

The oral and written testimony which we submitted to your committee goes into detail about the failures of the OCC, especially in connection with ACORN's challenge of Hibernia National Bank's application to acquire a bank in Lafayette, LA. One example of OCC's negligence in the Hibernia case is that OCC overlooked the fact that Hibernia had not been keeping fair lending data, a fact which made it much more difficult for ACORN to prove that Hibernia lending patterns are deeply discriminatory.

The Federal Reserve Board earns a grade of C-. The Fed gets a better grade than the other regulators because it has examiners who specialize in CRA and related laws, and has an apparatus capable of discovering community credit needs.

A year ago the Fed would have earned a grade of C+. But as ACORN explained in our written testimony, the policies and practices of the Fed in connection with CRA have been deteriorating. The Fed is, for example, no longer willing to make routine extensions of comment periods on bank applications in order to promote discussion and negotiation between banks and community groups.

The Fed is apparently telling its District offices that it is no longer a priority to get banks to sit down with community groups; the District offices and national staff have been directed to simply look at the CRA record as it is presented by the bank making application. Governor Seger has made it clear to staff that emphasis from now on will be on speed of processing applications. This represents a significant change in the application of policy over the last year, if not a change in the policy itself.

Q2. The private mortgage insurance companies charge that FHA is failing to discharge its responsibility to provide mortgage insurance for low income borrowers. Does your experience support this charge. The private companies say that FHA should be more tightly targeted to serve only low income borrowers. Do you think such tighter targeting would help or hinder community reinvestment?

A2. Healthy neighborhoods have to receive extensions of all types of credit, rather than becoming reliant on just one. A lot of FHA lending already goes on in low income neighborhoods, and this is especially important because FHA still insures 95% and 97% mortgages.

The issue is not whether FHA is doing its job. There are certainly problems with FHA. The program is overly restrictive on some standards and needs to become more sensitive to the particular credit needs in low income communities, but these improvements should be made without fundamentally altering FHA.

FHA was designed to help first time home buyers, and middle income and working class people, and was specifically aimed at facilitating the purchase of suburban tract homes. FHA was never intended to exclusively serve the inner city.

And there are real disadvantages for residents of low and moderate income neighborhoods when the percentage of FHA insured and VA guaranteed loans in a neighborhood gets too high. It sends the wrong signals -- it suggests that it is unsafe for conventional lenders to do business in that neighborhood.

FHA was not set up to serve areas which conventional lenders considered undesirable and there are at least three good reasons not to make FHA a low income program.

- First, the unfortunate fact is that programs targeted to exclusively benefit low income people are politically vulnerable; programs for low income people are more likely to be shaved back or zeroed out than programs which serve a larger, more diverse group. Right now FHA enjoys the near unanimous support of Americans, and therefore of the Members of Congress.

- Second, middle class and working class people still need FHA in order to realize their dreams of homeownership. In some housing markets, FHA insurance is more essential to these groups now than ever. Congress should not strip the middle class of this program.

●Third, Private Mortgage Insurance companies should be required to serve low income neighborhoods. It is not just the government's job to meet the needs of low income people. The argument about FHA is a smokescreen sent up by PMIs to permit them to unload their responsibilities. The private mortgage insurers are the only element of the industry that is not required to abide by fair lending laws. ACORN strongly urges Congress to act now to bring PMIs within the scope of these laws.

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## United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
 URBAN AFFAIRS

WASHINGTON, DC 20510-8075

March 31, 1988

Mr. Allen Fishbein  
 Center for Community Change  
 1000 Wisconsin Avenue, N.W.  
 Washington, D.C. 20007

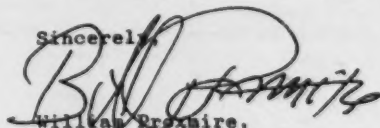
Dear Mr. Fishbein,

I would appreciate your answering the following question for the written record of the Community Reinvestment Act hearing.

1. Bankers say that they don't make loans in certain areas because there's no demand. Community groups say the problem is on the supply side. What do you think the major obstacles are in getting supply and demand for loans in balance ... are there obstacles in the way business is done by realtors? lenders? mortgage insurers? secondary market brokers?
2. How would you grade the Federal agencies, using the traditional A-B-C-D-F system? Include reasons, please.
3. You assert that agencies have failed to spot even routine technical violations. Please give examples.
4. You cite unfair and arbitrary handling by the agencies of applications. Can you give examples.
5. Please elaborate further on your recommendations for improving CRA.
6. Is there a evidence of a shortage of commercial loans in lower income neighborhoods? What is the evidence?. Would disclosure of such loans help solve this problem?

Please submit your answer within two weeks of your receipt of this letter, in order that the record may be published expeditiously.

Sincerely,

  
 William Proxmire,  
 Chairman



## center for community change

May 10, 1988

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Honorable William Proxmire  
 Chairman  
 Committee on Banking, Housing, and  
 Urban Affairs  
 United States Senate  
 Washington, D.C. 20510-6075

Dear Senator Proxmire:

This is in response to the questions contained in your March 31, 1988 letter.

Response to question number 1

The disinvestment of older urban neighborhoods occurs for a variety of reasons. Disinvestment often results from prejudice, ignorance, or sheer laziness on the part of financial institutions as well as other areas in the real estate transaction process.

a) Prejudice -- A continuing obstacle to lending in inner-city and predominately minority communities is the discriminatory legacy of the past, and the failure on the part of lender and regulators to appreciate the depth of the problem. While CRA, the Fair Housing and Equal Credit Opportunity Acts have presumably changed methods of doing business in recent years, the perceptions of both lenders and the customers it serves are only beginning to change.

For many years discrimination in housing and mortgage lending were interwoven and institutionalized in every aspect of real estate transactions. The legacy of discrimination found its way into modern underwriting standards and practices. It is why lending patterns still reflect redlining or differential treatment, even when that is no longer the intention of the financial institution or its personnel.

The recent series that appeared in the Atlanta Journal-Constitution illustrates the continuing obstacles minority mortgage loan applicants face in obtaining credit from banks and thrift institutions (see attachment A-1, A-2, A-3, A-4). According to a study conducted by the newspaper, lenders were five times more likely to make mortgage and home improvement loans to predominately black neighborhoods than they were to predominately white counterparts.



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The findings contained in the Journal-Constitution's study are similar to findings in studies conducted in other cities. These other studies were cited in my March 22, 1988 written testimony to the Committee.

While this research does not necessarily indicate that the lending institutions in these cities were intentionally discriminating, it does suggest that underwriting and other loan policies, practices, along with negative perceptions by both lenders and community residents about one another pose obstacles to increasing the supply of housing credit to these areas.

b) Ignorance -- Despite the existence of many successful reinvestment partnership efforts, involving lenders, community groups, and local governments, some bankers appear to harbor the notions that lending in the older urban neighborhoods is somehow inherently riskier than lending elsewhere.

The testimony the Committee heard from bankers on March 22 is hopefully an indication of a growing awareness that lending in inner-city neighborhoods can be profitable. Both Richard Hartnack, First National Bank of Chicago, and Jack Kolesar, Ameritrust Development Bank, testified about how their banks have successfully invested in not only single family lending, but loans to multi-family rehabilitation projects and other community development efforts. There is really no good reason for lenders to continue to believe there is greater risk in lending to the inner-city than there is to lending to the oil patch or to third-world nations.

c) Laziness -- Lenders often cite the lack of demand in inner-city neighborhoods to cover their failure to affirmative market their credit products in these areas. "Lack of Demand" usually means that lenders believe there are a lack of creditworthy borrowers seeking loans to reside in these areas.

Researchers continue to debate the appropriate methodology for measuring the true demand for mortgage credit. Yet, mortgage demand is primarily a function of marketing. Effective marketing requires lenders to seek out both active and latent demand for credit needs if they are truly interested in serving the credit needs of urban neighborhoods. The plethora of affirmative lending programs that have emerged in recent years, primarily through CRA agreements with community groups, demonstrate that a very active demand for credit exists in urban neighborhoods. The experience with these agreements and other affirmative lending programs suggests that lending can be increased to areas that were formerly shunned by financial institutions, providing that these institutions offer the appropriate mix of credit products (i.e. low-downpayment loans, flexible underwriting

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criteria that addresses the repayment constraints of low income borrowers).

Recently, new obstacles appear to be emerging to providing loans to urban mortgage markets. Lenders appear to be moving to instituting minimum loan requirements, or tiered-pricing, in which they charge a higher interest loan on a small loan than a larger size loan. Clearly, these types of requirements have a discriminatory effect on modest income borrowers attempting to obtain housing loans in urban neighborhoods.

Lenders cite other factors, such as restrictions imposed by private mortgage insurers or requirements by secondary market purchases as the reason for the institution of these new features. As far as we have been able to tell, private mortgage insurance companies appear to be less willing to underwrite low-downpayment loans (i.e. 95% loan to value). If PMI becomes unavailable in urban markets, lenders will not make loans with high loan to value ratios. To the extent that this is occurring it poses a significant obstacle to mortgage lending in urban neighborhoods.

Another obstacle cited by lenders is that they encounter difficulty in selling urban mortgage loans to FNMA, FHLMC, or other, usual unspecified, investors. It appears that the secondary market agencies may have imposed unnecessary restrictions on urban loan purchases, by interpreting their underwriting requirements too narrowly. FNMA has established an office to coordinate low-income housing to address these types of problems. FHLMC has yet to undertake a similar initiative. It is unclear whether FNMA's new initiative will reduce or eliminate any obstacles that may have existed with that agency.

Perhaps even more disturbing, is that lenders sometimes point to restrictions imposed by institutional investors, such as insurance companies, as limiting their ability to sell urban loans. These obstacles are more difficult to track since these institutions are not regulated for the types of purchases they make and generally do not come under public scrutiny.

We urge the Committee to instruct GAO to undertake an investigation to determine the extent to which the mortgage insurance industry and the secondary market are posing obstacles to lending in urban areas.

#### Response to Question number 2

Grading the federal supervisory agencies' CRA enforcement is always a difficult task for three basic reasons: 1) agency enforcement is generally weak across the board; 2) enforcement levels appear to change from time to time, both from agency to

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agency and even within various regions and districts within the same agency; and 3) the lack of public information about agency enforcement activities. However, with these three factors as caveats, let me attempt to respond to your question by providing our evaluation of both the positive and negative aspects of each agency's enforcement efforts.

**Federal Reserve System -- Grade: D+**

positive points: Former Chairman Volcker charged the Consumer Advisory Council with responsibility to evaluate the Fed's CRA implementation efforts. Exams -- agency uses consumer specialists to examine the relatively small number of banks it supervises (about 1,000) on routine basis. D.C. Division of Consumer and Community Affairs exhibits high degree of professionalism and commitment to enforcement. The Fed is only agency to include examiner contacts with community groups as routine part of CRA examination. Applications -- Fed encourages parties to CRA disputes to resolve differences, sometimes resulting in negotiated affirmative lending agreements between applicant and community protestants.

negative points: Few of the Consumer Advisory Council's recommendations for improvements in CRA performance were ever implemented by the Fed. Exams -- no evidence that Fed supervised banks are rated any more strictly than are institutions examined by the other federal agencies. What is more, there is evidence that exam procedures are uneven from Reserve District to Reserve District. Applications -- The Fed has not denied an application for CRA reasons by either bank holding company or state-chartered member bank. Fed seldom convenes public hearings on CRA protested applications (only one in past 8 years). Moreover, as testimony at the hearing illustrated, community groups find the Reserve Banks increasingly arbitrary and inconsistent in the way they process protested applications.

Summary: Examiner hours devoted to CRA declined much less for FRB than other agencies. Unfortunately, FRB's enforcement program does not appear to have resulted in tougher CRA exams. CRA protest procedures need to be improved.

**Office of the Comptroller of the Currency --Grade: D-**

positive points: D.C. Office of Customer Affairs relatively active in convening conferences and encouraging greater bank participation in community development. The OCC has also convened a number of meetings with community and consumer groups to discuss relevant enforcement issues. Exam -- After de-emphasizing CRA exams for many years, OCC has started to devote more examiner time to this area. The OCC has used circulars to nationally

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chartered banks as means of encouraging them to provide advanced notice of branch closing. Applications -- none.

negative points: Exams: New exam procedures mean that nationally chartered banks with under \$1 billion in assets will be examined infrequently. Virtually all banks examined receive "1" or "2" CRA ratings. Community group contacts not required to be part of CRA exam. Applications: No denials on CRA grounds in past eight years. OCC has been reluctant to hold public hearings on protested applications. Regional offices appear to use arbitrary procedures for processing protested applications. OCC orders do not contain findings and conclusions on issues presented by protestants.

Summary: It does not appear that recent OCC efforts to upgrade CRA exam have resulted in noticeably improvements in enforcement. CRA protest procedures should be revised to encourage greater community input.

FDIC -- Grade: F

positive points: The agency has had at least one meeting in recent years with community and consumer groups to discuss relevant issues. Exams -- FDIC claims it has increased emphasis on CRA enforcement in last year. Applications -- Washington consumer staff has been responsive to complaints by community protestants about arbitrary rulings by regional staff concerning the handling of protested applications.

negative points: Exams: The agency almost completely de-emphasized CRA and consumer exams over past eight years. Outside contacts with community groups not required as part of exam. Exams are infrequent, sometimes 6 years between compliance exams, with almost every institution assured of a passing grade. Applications: No denials on CRA grounds in over eight years. FDIC orders do not discuss findings and conclusions on CRA issues.

Summary: Once the agency with the best enforcement record, FDIC has almost completely de-emphasized CRA exams. Regional officials appear unfamiliar with their own procedures regarding CRA protests.

FHLBB -- Grade: F

positive points: Current FHLBB Chairman has indicated he will reinstitute Community Investment Fund to encourage broader thrift participation in community development activities. Exams -- none. The FHLBB CRA rating system which provides for three positive and two negative ratings has advantages over the system used by the three banking agencies. Applications --

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Washington, D.C. staff has been responsive to complaints about handling procedures on protested applications. Unlike the other agencies, the FHLBB seems to routinely grant requests for hearings on protested applications.

negative points: Exams -- Sharply reduced resources allocated to consumer and CRA exams. The agency does not use consumer specialists to examine thrifts for CRA purposes. Applications: Only 1 denial on CRA grounds since CRA enacted. FHLBB orders do not include findings and conclusions on issues raised by CRA protests. District Bank officials make little or not effort to encourage resolution of protests.

Summary: Record suggests CRA has had very low priority at FHLBB, a point acknowledged by the current chairman.

#### Response to Question number 3

My written testimony refers to three examples of clear-cut technical violations of CRA and the Home Mortgage Disclosure Act which were either undetected or overlooked by federal bank examiners.

- Bank of New York -- Federal Reserve Board conceded that bank's CRA community delinquency was too narrowly drawn and in violation of Board regulations after issue was raised by community protestant. See Bank of New York, Federal Reserve Board Bulletin February 25, 1988.

- First National Bank of Commerce -- The bank's CRA Statement does not list home purchase loans as one of its credit products although bank makes over 50 home purchase loans a year. The Office of Comptroller of the Currency has yet to require the bank to modify its CRA Statement, although it is in clear violations of the regulations. See Attachment B.

- Leader Federal Savings and Loan Association -- Institution did not report mortgage lending activity in a manner prescribed by Regulation C. Federal Home Loan Bank Board did not require the institution to comply with reporting requirements until violation was cited in a CRA protest filed by local community coalition. See Attachment C.

#### Response to question number 4

Three examples of unfair and arbitrary handling of protested applications by the FHLBB, FDIC, and OCC were cited in my testimony. These examples are discussed in additional detail in Attachments D-1, D-2 (OCC), E-1, E-2, E-3, E-4 (FDIC), and C (FHLBB).

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**Response to question number 5**

In my testimony I indicated four major avenues for reforming the CRA enforcement process which we support: 1) the need for expanded agency enforcement efforts; 2) the need for greater agency accountability and expanded public disclosure of bank lending activities; 3) revising the current CRA rating system; and, 4) reform of the application review and CRA protest process. Let me elaborate on each of these areas.

**1. Improved agency enforcement**

CRA enforcement needs to receive higher priority within each of the agencies. An important method for ensuring that CRA receives higher priority from the agencies in the future is to require each agency to establish a separate consumer division.

The separate division would be responsible for conducting CRA examinations using a trained staff of professional CRA examiners. The consumer division would also respond to consumer complaints, enforce laws regarding consumer protection, civil rights, and community reinvestment. We also believe it is essential that the head of these consumer affairs divisions should report directly to the agency head. The division should also make recommendations on pending expansion applications directly to the agency head based on the CRA and consumer compliance records of the applicant institutions.

At the present time, only the Federal Reserve Board has a separate consumer division. The division does not, however had authority to report directly to the Board on CRA factors related to pending applications.

Another important step for improving agency enforcement would be to exempt the banking agencies from the requirements of the Federal Paperwork Reduction Act for information related to CRA, fair lending, and consumer compliance exams. The Act directs the agencies to reduce the reporting and record keeping requirements that they impose on financial institutions.

There appears to be some uncertainty as to what extent the banking agencies are covered by the Act. However, the FHLBB, OCC, and FDIC have chosen to place key reporting requirements, such as the Fair Lending Reporting, under the Act's purview. Consequently, the Office of Management and Budget has exerted strong pressure on these agencies to scale back on the reporting requirements these agencies use to determine whether financial institutions are in compliance with the Fair Housing and Equal Credit Opportunity Acts.



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The pressure on the agencies to scale back on fair lending reporting has intensified in recent years as they have expanded reporting requirements on financial institutions in other areas, such as safety and soundness. The Paperwork Reduction Act, in effect, creates a "zero-sum" game, in which the agencies endeavor to reduce reporting requirements in the fair lending and consumer compliance areas, as they add safety and soundness reporting requirements, such as expanded Statement of Condition Reports.

If Congress grants banks new powers, it is likely to result in new reporting requirements to address new additional safety and soundness and other concerns. This will impose even greater pressure on the agencies to reduce reporting requirements in the consumer and fair lending areas.

Reporting requirements are essential to the enforcement of laws like the Fair Housing and Equal Credit Opportunity Acts. Congress ought to provide specific exemptions for reporting requirements that are a necessary part of consumer compliance, fair lending, and community reinvestment exams.

2. Greater agency accountability and expanded public disclosure of the lending practices of financial institutions.

a) public disclosure of CRA ratings and examination reports.

One of the best methods for improving the CRA examination process would be to require each agency to publish the rating and written evaluation it assigns to each institution. The disclosure of this information would permit citizens to compare the performance of their local institutions in addressing community credit needs, and thus, providing lenders with an incentive to improve their performance. It would provide the agencies with a greater stake to conducting tougher CRA exams, since the results of their efforts would be subject to public scrutiny.

Each agency should be required to disclose the written evaluation and rating it assigns a bank after each CRA examination. The written evaluation should contain the following information: the examiner's conclusions for each CRA assessment factor and the facts supporting such conclusions. It should also include the examiner's findings concerning the institution's technical compliance with CRA regulations. The written evaluations should give special attention to the bank's performance in serving the credit needs of low and moderate income persons, small businesses, and any low and moderate income neighborhoods within the bank's community.

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## b) commercial loan disclosure.

As the Home Mortgage Disclosure Act has unquestionably demonstrated, disclosure of information about the lending patterns of financial institutions is an effective deterrent against credit discrimination and relatively low-cost methods for encouraging improved lender performance. Extending HMDA to include reporting by depository institutions of their commercial lending activities would provide regulators and citizens alike with important information about lender performance and would encourage these institutions to better meet local credit needs.

The expanded disclosure act should require bank to provide reporting on a census tract basis for each the commercial and industrial loan they have either originated or have outstanding each year. An additional itemization should be provided for small business loans the bank has originated each year.

## c) Annual Reporting to Congress.

Each agency should be required to report annually to Congress on the number of examiner hours devoted to consumer compliance, CRA, and fair lending for the preceding year. Detailed reporting on the resources devoted to consumer and CRA exams would provide Congress with a useful measure of the how seriously the agencies are taking their enforcement responsibilities in these areas.

## 3. Reform of the CRA rating system

The inadequacy of the current rating system was discussed in my testimony. We would prefer to see a rating system that would measure a bank's CRA performance relative to the performance of other banks of a similar size and with similar resources.

Institutions should be rated on a five-tiered scale that would use the following definitions: #1 - excellent or outstanding; #2 - good; #3 - average; #4 - limited effort; #5 - poor. Under this system, most institutions would receive a #3 CRA rating, with institutions devoting resources greater than their peers receiving higher grades.

Further, we favor a system that would prohibit the Fed from approving any application by a bank holding company to acquire another BHC or bank, or to engage in new powers in securities, insurance, real estate, or any other area in which applications are required under Section 4(c) of the Bank Holding Company Act unless the applicant and its subsidiary banks have excellent or good CRA rating(s) under the revised rating system.

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These reforms are incorporated into a CRA Enforcement Amendment that has been sponsored in the House Banking Committee by Reprs. Kennedy, Garcia, Fauntroy, Schumer, Mfume, and Flake. A copy of the Section-By-Section Summary of the Amendment is included as Attachment F.

4. Reform the application review and CRA protest procedures.

The burden of ensuring compliance with CRA has largely rested on community groups because of the inadequacies in the agencies enforcement efforts. The major means of input that community groups have in the CRA process is to intervene in application proceedings. The CRA protest is used in order to bring to the agencies' attention various weaknesses in the CRA performance of applicant banks. The agencies have acknowledged that the protest process provide them with important information for making judgments about the performance levels of the institutions they supervise.

Unfortunately, the current application and protest procedures do not seek to maximize citizen involvement in the CRA process. We favor reforms that would accomplish the following:

a) provide better public notice of pending applications.

Newspaper notices that applicants are required to publish should be simple, "plain English" and should explain that in deciding whether to approve the application, the agency will consider, among other factors, the bank's performance in helping to meet local credit needs. Moreover, the agency mailings to interested parties on pending applications should be made more timely and should precede the beginning on the comment period for a pending application.

b) expand the public comment period.

In general, the present comment periods are too short to permit local community groups to prepare the documentation that is necessary to file a substantive CRA challenge. The comment periods for merger and acquisition of bank holding companies and banks and thrifts should be expanded to 60 days. The comment period for other applications covered by CRA should be expanded to 30 days.

c) Standards are needed for judging CRA protested applications and implementation.

Each of the agencies should issue clear explanations of the standards each uses for weighing evidence concerning the

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CRA record of applicants. Agency order should contain precise information setting forth the conclusions and the facts supporting the conclusions on the issues raised by a protested application. The agencies should hold hearings on any protests raising substantial CRA issues.

Lastly, although over 100 negotiated lending agreements have been occurred over the past three years, the agencies have yet to publish guidelines for their examiners on how to weigh performance of institutions in implementing the terms of these agreements. Guidelines spelling out the method the agency will take to ascertain performance and solicit community comment are needed. These guidelines should discuss the weight that implementation of agreements will have on future applications by affected institutions.

#### Response to question number 6

Access to credit is vital to the growth of small firms. Yet, many small firms encounter difficulty in obtaining certain types of financings from commercial banks, especially longer term credit and start-up and expansion financing.

The report of the National Commission on Jobs and Small Business, co-chaired by former Presidents' Ford and Carter, concluded that there was a capital shortfall for small businesses, especially minority enterprise. The Commission attributed part of the reason for the financing gap to "a bias against small business on the part of the financial community (including banks)." The report also emphasized that the lack of capital created nearly insurmountable problems in minority communities, "most of which lack the resources the small business owner needs, especially the pool of capital that family and friends can provide."

According to a 1982 Federal Reserve Board bank survey, commercial banks believe that they provide 75% of the total debt of their small business borrowing customers. Other research indicates that small businesses are usually limited to banks located within the immediate community as their potential sources of credit.

At the same time, several surveys of small businesses reveal that many small firms are dissatisfied with services offered by local banks. For example, a poll of 1,047 small businesses in New York taken by Chemical Bank in 1983 indicated that 52% of those surveyed rated the services provided by local banks from fair to poor. A total of 65% of the respondents said that they thought the banks are more interested in servicing big business instead of small companies.

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The National Federation of Independent Business has conducted a series of surveys of its members which reveal that small businesses assign highest priority to a personal relationship with their banker and credit availability. Yet, when asked to rate the actual performance of their banks, the surveys rate banks relatively poorly in cultivating personal relationships. Other studies indicate that small business lending activity varies widely between commercial banks, even commercial banks of similar size operating in the same or similar communities.

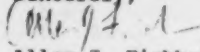
Just last year, a study issued by the Woodstock Institute found that Chicago banks made twice as many loans to suburban businesses as they did to city businesses. Using data provided under the City of Chicago's depository ordinance, the research group found that 70% of all loans made within the city limits were to downtown businesses. The study suggests that only a tiny fraction of local banks commercial lending found its way to businesses located in Chicago's neighborhoods.

We believe that requiring banks to disclose the geographic location of their commercial lending activity would provide regulators, government officials, small business associations, and economic development groups with a valuable tool for uncovering credit gaps in local economies. The experience with HMDA suggests that even the disclosure of commercial lending activity would encourage banks to be more sensitive to the needs of small businesses, especially minority-owned and neighborhood businesses, which are not well served by financial institutions.

It should be noted that commercial loan disclosure is currently included in the committee print of the new banking powers bill pending before the House Banking Committee. We would hope that the Senate would include a comparable provision in conference.

Please feel free to call upon me if you desire any further amplification on any of the responses contained in this letter.

Sincerely,



Allen J. Fishbein  
General Counsel

Enclosures



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April 25, 1988

Senator William Proxmire  
Chairman  
United States Senate  
Committee on Banking, Housing, and Urban Affairs  
Washington, DC 20510-6075

Dear Senator Proxmire:

This is in answer to the question you asked me in your letter of March 31, 1988. The question was about the obstacles in the way of getting the supply and demand for loans in balance.

First, I would like to suggest that there is no natural level of supply and demand. People have needs for credit. These needs can become a real demand for credit if there are credit instruments that people in need can afford. Thus, the main obstacles to serving the "needs" of people for housing and business credit are related to loan product development and marketing of these loan products. There is a point where the private lending industry simply cannot serve local needs because of the risks involved or because the returns on a loan product are simply too low, and they represent such a significant portion of the portfolio of a given lender that these risks pose a threat to the security and survival of the institution.

I place the question in this context because the level of demand and supply is constantly changing. The many lending agreements that community groups have developed with lenders, beginning in the early 1970s, before there was a Community Reinvestment Act, almost always have the effect of changing the definitions of what demand can be met by changing product development and marketing processes of local financial institutions. Moreover, even the questions of risk and low rates of return are not absolutes. The ability of community groups and lenders to engage public agencies and use public and foundation funds for insurance, interest rate subsidies, and grants, as well as the ability to use both public and private funds for training, counseling, and the creation of sound community-based developers and skilled lending officers all show how the creative use of these resources can radically change the definitions of demand and supply.

In testimony before your Committee on March 22, Gale Cincotta listed a range of successful agreements and programs,



many of which found ways of reducing alleged risk and reducing the costs of lending for both the lenders and the borrowers. On that same day, the statements of Richard Hartnack, of First National Bank of Chicago, and Jack Kolesar, of Ameritrust Development Bank, attest to the ability of these programs and efforts to reduce risk and increase the supply of lending in areas previous defined as having no effective demand by existing banking standards.

For lenders, there are many obstacles in the way of creative product development and marketing. The first obstacle is their attitude about older, rural, and inner-city communities. Changing this attitude has been one of the most important activities of community groups. These groups have often resorted to renting buses to take lenders on tours of the communities they fear, but which they generally have never seen. A new report on the banks of West Virginia\* confirms the literature and experience of community reinvestment activities that the perception of risk by lenders, a perception not based in objective analysis or data, remains the main obstacle to creative community lending.

Other obstacles are created by deregulation and the increased levels of competition in the financial industries. This contributes to management practices to reduce all lending to large individual corporate or foreign loans or to standard products with the most upscale or most broadly-based markets. This discourages lenders, and especially local lending officers, from engaging in the more varied and often hand-tailored lending techniques and products that may be required in some rural areas, older areas and areas of economic distress.

In the housing markets, major lenders do not solicit minority real estate brokers as much as they solicit white brokers in upscale communities. Major lenders do not engage in "calling" on local businesses in inner-city communities and minority communities. It is this marketing that really attracts business - and until this marketing in older, inner-city, minority, and rural communities is an active part of the banking industry's behavior, there will be a large gap between the supply of loans and the real demand that can be developed at reasonable risk and reasonable rates of return.

Historical patterns in the real estate industry also create obstacles to more creative lending in the housing markets. The profession of realtors developed early in this century with a code of ethics that required the segregation of the races. Those prejudices have given way vary little over time. Even today, in most cities with large minority populations, the realtors remain separately camped in white and minority areas, with little overlap. In most cases, the major realtors, with the best access to the widest range of mortgage lenders, concentrate and focus

their business in white and newly developing communities. Minority realtors and minority neighborhoods are left mainly in the hands of mortgage bankers who have little incentive or desire to engage in creative lending. These mortgage bankers operate as agents for the secondary market, and they limit their lending to the products most desired by that secondary market.

That brings us to the secondary market. In response to the efforts of your Committee and pressure from community organizations and with some behind-the-scenes prodding from the Justice Department, FNMA and Freddie Mac both made major revisions in their underwriting standards by the time of your secondary mortgage market hearings on December 19, 1978. But, as I noted in my statement before this Committee on March 22, 1988, a great many of these revisions have eroded over time, leaving little left. FNMA has - in response to extreme pressure by the National Peoples Action and ACORN - made some effort to return some of the anti-discrimination language and guidelines which it had eliminated in recent years. But FNMA is still not back to where it was ten years ago, and it has made only some very minor efforts to begin to deal with the rigid standards it applies to credit underwriting and the purchase of loans with reduced interest rates. Freddie Mac has essentially acknowledged that this issues raised by the community groups deserves some review - but it has made no significant effort to return to the anti-discrimination standards of a decade ago.

In addition, we find that many lenders have developed the impression that FNMA and Freddie Mac have certain standards for minimum loan sizes, types of properties, zoning, and neighborhood value trends that discriminate against older neighborhoods and properties in areas with lagging local economies. Both FNMA and Freddie Mac claim that most of these alleged standards are not correct. Neither corporation has done much to communicate with lenders to insure that these incorrect perceptions are corrected, except in cases where community groups force the lenders to contact FNMA or Freddie Mac to check out the standards. Generally, this is symptomatic of the erosion of anti-discrimination efforts on the part of both major secondary market entities.

The final report of the National Housing Task Force\*\* indicates the major role that community-based developers have played in creating a supply of affordable housing. Yet FNMA and Freddie Mac still use processes and terms that favor large private builders and developers. The limited ability to sell loans in the secondary market is a major obstacle for non-profit, community-based developers of affordable housing. In spite of major efforts to get a better response from FNMA and Freddie Mac, only limited progress has been made. Ironically, the head of FNMA was a member of the Task Force. Moreover, FNMA is a corporation with an obligation in its charter to help meet the

nation's housing needs.

The restrictive standards in the secondary market are reflected in the private mortgage insurance markets as well. In spite of many proven programs to make loans to moderate and lower income people in distressed rural and inner-city communities, the inability of people to get access to private mortgage insurance is a major obstacle to increasing the supply of loans in these areas. There is a kind of domino effect in the lending markets that begins with the secondary markets and the mortgage insurance and SBA insurance standards. In order to keep the lender's own capital as liquid and secure as possible, no lender wants to make a loan that cannot be insured or sold. Thus, restrictive and discriminatory standards in these industries are translated into restrictive and discriminatory standards in the lending industry. As realtors depend upon lenders for their business, these restrictive standards are finally translated into restrictive and discriminatory standards in the real estate industry as well.

In a note of tragic irony (and reflecting the limited experience of the members of the Task Force in reinvestment activities and the history of redlining), the National Housing Task Force report recommends that single-family housing for lower income people is too risky for the private sector to handle. The report recommends that HUD take on these risks by relaxing some of FHA's standards and limitations and set aside special reserves for the increased losses it will suffer. This harkens us all back to the disasters of the early 1970s when an inundation of high risk FHA lending contributed to the destruction of minority communities all across the country. Cities like Chicago, Cleveland, and Detroit, to name a few, are still struggling to overcome the damage done by that last effort to save poor people through dumping their communities into the quagmire of FHA's abusive practices.

Of course, all of this takes place in an environment which is already racially discriminatory. While HUD has remained the great silent and invisible agency in this Administration, the Secretary has raised an unusually loud voice to point out the persistence of racism in the housing markets of the nation. As pointed out in the March 22, 1988, hearings, studies by community groups and academics as well continue to find race as a major factor in explaining the supply of loans in minority communities. This past week, the Atlanta Constitution/Journal ran a series of articles on discrimination in lending in that rapidly growing metropolitan area. I consulted on that study and can vouch for the carefulness and accuracy of the methods used. With controls for income and growth, the study found levels of lending by the major banks to be from two to thirty-eight times higher in white communities as compared to minority communities with a similar range of incomes and level of growth.

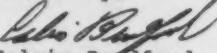
Yet, the FED, which has several times received CRA challenges from groups in this region claiming racial discrimination in lending, decided in the Trust Company Bank case, for example, that this was not a problem. (In the Hibernia case, where the FED did find that low levels of lending in minority communities were a problem, the FED has done nothing to make that bank comply with an order to change its practices.) As the Constitution/Journal articles reveal, Trust Company Bank makes three loans per 1,000 homes in white middle and upper income neighborhoods for every one such loan in similar black neighborhoods.

On the business side, the record of Trust Company stands as a clear statement of the overall problem in business lending. Sun Trust is the third largest bank in the state. It had the best record of SBA lending to women and minorities, with 20% of its SBA loans from 1982 through the first half of 1987 going to businesses owned by these people. But this amounts to just five loans each year to a rapidly growing market segment which is presently estimated at well over 100,000 businesses. When a lender of this size, with banks all over the state, cannot find more than a handful of minority and women-owned business to serve, it is hard to imagine that it is just benign "inefficiencies" in the market that produce this gap between a clear demand and a minuscule supply.

Finally, there are obstacles caused by the lack of funds and support for community-based developers, community action groups, and local business development programs and organizations. As the study in West Virginia also concludes, more lending could be done if the local businesses were more sophisticated in their credit applications. The successful experiences here in the United States, and in other countries, in various forms of small business incubators suggest that peer support, management support, and access to financing all can play an important role in developing successful new businesses in communities with economic problems. While the obstacles that exist in the real estate, lending, secondary market, and insurance industries represent the most fundamental roadblocks to defining and serving the potential demand in rural, minority, and older, urban communities, the parallel need to build the local capacity to get loans out is a growing concern for those involved in community reinvestment. But experience has shown that where there is a will on the part of the private sector and the local government to respond to community initiatives, this capacity can be developed by the local community and a more aggressive and creative financial community - in all its institutional forms.

I hope this provides you and your Committee with a full response to your question.

Sincerely,

  
Calvin Bradford  
Senior Fellow

\*Mountain Association for Community Economic Development,  
Commercial Bank Lending Patterns and Economic Development in West  
Virginia: Berea, Kentucky, January, 1988.

\*\*National Housing Task Force, A Decent Place To Live:  
Washington, D.C., March 28, 1988.



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

May 16, 1988

Dear Mr. Chairman:

Enclosed are answers to the questions raised in your letter of March 31, 1988, requesting information for the written record of the Committee's recent hearing on the Community Reinvestment Act.

We hope this information is helpful.

With best wishes.

Sincerely,

L. William Seidman  
Chairman

Honorable William Proxmire  
Chairman  
Committee on Banking, Housing  
and Urban Affairs  
United States Senate  
Washington, D.C. 20510

Enclosures



Question 1:

CRA requires your agency to assess a lender's performance in meeting local credit needs. What steps do your examiners take as part of the regular CRA examination to determine local credit needs?

Answer:

FDIC examiners do not perform an independent analysis of the credit needs of a bank's community. We deem those needs to be reflected in the bank's overall performance in responding to local loan demand. The FDIC assesses a bank's performance in meeting local credit needs by considering the bank's activities under the assessment factors outlined in Part 345 of its Rules and Regulations, as well as its Statement of Policy on the CRA.

The assessment factors include, but are not limited to, activities conducted by the bank to ascertain the credit needs of their communities and the bank's marketing of its services; the types of credit offered and extended by the bank to the community; the geographic distribution of the bank's loans; the impact of the opening or closing of any offices and the services offered at these facilities; the bank's compliance with anti-discrimination and other credit laws; and the bank's participation in community development in order to meet local credit needs.

The FDIC Manual for Compliance Examinations contains examination procedures for evaluating these assessment factors. Further guidance for evaluating a bank's performance is provided by the Uniform Interagency CRA Assessment Rating System, which also is included in the Manual for Compliance Examinations. Copies of each of these documents are enclosed. Additionally, in assessing a lender's performance, examiners draw on their own knowledge and awareness of the community and its credit needs.

Question 2:

Do your examination procedures require examiners to solicit the views of community groups and others, as part of the CRA examination process? If not, how do you assess local credit needs in order to evaluate how well an institution is serving these needs?

Answer:

As set forth in the FDIC's Manual For Compliance Examinations, examiners are authorized, but are not required, to conduct interviews with community members and groups. The purpose of such meetings, however, is not to assess local credit needs, but to determine community awareness of the bank's credit services and local perception of the bank in meeting community credit needs.

We assess a bank's success in serving local credit needs by reviewing, among other things, its advertising of credit services in low- and moderate-income areas, participation in community development programs, and small business financing.

Question 3:

CRA examination procedures provide examiners with general descriptions of the attributes that warrant an institution's receiving a particular rating.

- 2 -

What quantitative measures do examiners use to determine which rating an institution should receive? How do you assure that these standards are applied consistently?

Answer:

In conducting a CRA examination, examiners evaluate banks on a case-by-case basis taking into account an institution's size, expertise and locale. Community credit needs often differ with the specific characteristics of each local community. Banks are evaluated on the basis of attempts to ascertain and help meet community credit needs in the context of local circumstances and resources. When feasible, examiners use in their analysis available statistical information as well as comparisons with similar banks serving the same or a similar community.

Question 4:

In your testimony you indicate that the geographic distribution of commercial and small business lending is an important aspect of evaluating an institution's CRA performance. How do your examiners determine such distribution?

Answer:

Small business loans represent one type of credit which the Corporation believes is directly related to the purposes of the CRA. While we do not have a precise definition of small business lending, small business loans are regarded generally as any loans to local firms which, because of their size, have limited access to sources of funding.

The FDIC's Manual For Compliance Examinations contains directions for examiners in reviewing and assessing the geographic distribution of a bank's loan portfolio, credit applications and credit denials. Essentially, examiners first review a bank's delineation of its community for reasonableness, especially to ascertain that small businesses and low- and moderate-income neighborhoods have not been arbitrarily excluded. A review of a bank's internal credit files and other records is then conducted. This review is to determine whether there is any indication of a geographic distribution of credit extensions, applications and denials signifying failure to serve certain areas of the defined community, particularly small businesses and low- and moderate-income neighborhoods. In this context, examiners also review the reports of examination and workpapers from other examination programs (e.g., fair lending examination reports).

Question 5:

You stated that you prefer to make conditional approvals, with commitments to improve performance, to outright denials, when agencies have weak CRA performance ratings. What procedures do you have in place to monitor fulfillment of the conditions you set? What action has your agency taken when the institution has failed to meet its pledge? Please provide specific examples of such actions.

- 3 -

**Answer:**

The FDIC usually works with a bank to resolve any existing CRA problems prior to taking action on the bank's application. In situations where a bank with a less than satisfactory CRA rating files an application, the FDIC does not approve the application unless the bank agrees to resolve the CRA problem.

Such commitments may be informal or may be stipulated in a memorandum of understanding. Fulfillment of these conditions is monitored through the examination process. In every such situation documented by the FDIC, the bank has complied with its pledge.

In May 1987, the FDIC's Division of Bank Supervision implemented a new Applications Tracking System which enhances our ability to track applications that were protested based on CRA performance factors and to determine whether any CRA-related conditions imposed upon the approved applications are being met.

**Question 6:**

The Federal Reserve Board has established specialized examiners with a separate career ladder, and maintains separate regional offices for CRA enforcement. Are you considering adopting such a system? If not, why not?

**Answer:**

In January 1987, we reorganized the FDIC Office of Consumer Affairs. Like the structure at the Federal Reserve, the FDIC OCA operates independently of our Division of Bank Supervision. It also reports directly to the Office of the Chairman and continuously evaluates the adequacy of the Corporation's compliance examination program.

The FDIC also has consumer/compliance specialists assigned to each of its eight Regional Offices. Within these Offices there are a number of field examiners who work primarily on compliance examinations, which include a review of a bank's compliance with the CRA. To improve our current operations, we are studying several options, one of which is the development of a larger core group of examiners for the compliance area, including CRA. We have not yet determined which option would be the most cost effective or result in the most efficient use of resources.

Under our current structure, we have been allocating more resources to compliance examinations since 1985, and we are providing more training for an increasing number of examiners. We plan to continue our emphasis in both these areas.

**Question 7:**

What is your agency's policy regarding settlements between applicants and community groups... do you monitor actions under such agreements, and do you factor in the follow through in subsequent CRA ratings?

**Answer:**

The FDIC reviews such settlement agreements as part of the regular examination process. Generally, however, the FDIC does not monitor CRA-related settlement agreements unless they are associated with a CRA protest. The situation leading up to and resolved by the agreements is among the factors we consider in determining the bank's CRA rating.



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Comptroller of the Currency  
Administrator of National Banks

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Washington, D.C. 20219

May 17, 1988

The Honorable William Proxmire  
Chairman  
Committee on Banking, Housing, and  
Urban Affairs  
United States Senate  
Washington, D.C. 20510-6075

Dear Mr. Chairman:

The following information is provided in response to your letter which posed the following questions for the record of the Community Reinvestment Act hearing.

1. CRA requires your agency to assess a lender's performance in meeting local credit needs. What steps do your examiners take as part of the regular CRA examination to determine local credit needs?

During the assessment of a national bank's performance under the Community Reinvestment Act (CRA), our examiners review written comments contained in the bank's CRA public file that specifically relate to the bank's performance in helping to meet community credit needs. Minutes from board of directors meetings also are reviewed for discussions of community credit needs and activities designed to meet those needs.

Our examiners determine from bank records and through interviewing bank officers and employees the extent to which the bank has conducted activities to ascertain the credit needs of its community. The process may include evaluating studies conducted or reviewed by the bank concerning local credit needs, bank management review of public comments received in response to the bank's CRA statement, and the extent of the bank's efforts to communicate with members of its community regarding the credit services it is providing.

Examiners may also review CRA statements of other banks and savings and loan associations within a community, to compare the types of credit being offered, and learn about credit activity in the community. Examiners also ensure that the types of credit listed correspond to the types of credit actually extended by the institution.



- 2 -

2. Do your examination procedures require examiners to solicit the views of the community groups and others, as part of the CRA examination process? If not, how do you assess local credit needs in order to evaluate how well an institution is serving these needs?

Examiners may solicit the views of members of the community to gain a balanced perspective in order to assess performance under CRA. Outside contacts are a desirable supplement in certain circumstances to complete an analysis of a bank's performance when, in the judgment of the supervising office, either: (1) they are necessary to supplement or verify information obtained from a bank, without which the examiner cannot reach conclusions with reasonable confidence about the bank's CRA performance or compliance with fair lending requirements, or (2) they are warranted as an efficient way to secure information about overall credit needs and lender activities in a given community, as background for the analysis of all of that community's national banks. Examiners also are instructed to contact a person or organization who has raised a substantive concern about the bank's CRA performance in a written CRA comment.

3. CRA examination procedures provide examiners with general descriptions of the attributes that warrant an institution's receiving a particular rating. What quantitative measures do examiners use to determine which rating an institution should receive? How do you assure that these standards are applied consistently?

It is difficult to apply quantitative standards to a qualitative process such as rating a bank's performance under CRA. The Uniform Interagency Community Reinvestment Act Assessment Rating System provides the regulatory agencies with a uniform means to identify those areas where an institution can improve its performance in helping to meet local community credit needs. The system also facilitates uniform and objective composite CRA ratings.

Each financial institution is assigned a composite CRA rating that is based upon the institution's performance in meeting various community credit needs. This system requires rating five "performance categories" or components from which the overall composite CRA rating is derived. The system is not quantitative in that the basis of each respective component rating is an examiner's judgment of the institution's performance based on how well the institution meets the descriptive characteristics given for the five component ratings. The component ratings are then evaluated to reach the composite CRA rating.



- 3 -

4. In your testimony you indicate that the geographic distribution of commercial and small business lending is an important aspect of evaluating an institution's CRA performance. How do your examiners determine such distribution?

The banks are responsible for conducting their business in such a manner as to demonstrate performance under CRA and for documenting that performance. Therefore, much of the necessary information on the geographic distribution of credit activities is often readily available from the bank being examined. Also, a major portion of our safety and soundness examinations involves a qualitative and quantitative review of a bank's loan portfolio. When CRA examinations are conducted concurrently, the CRA examiner has direct access to pertinent information regarding commercial and small business lending generated in the loan portfolio analysis. If separate examinations are conducted, the work papers and loan portfolio evaluation results are available for the CRA examiner to use in developing a clear sense of the bank's lending patterns.

5. You stated that you prefer to make conditional approvals, with commitments to improve performance, to outright denials, when agencies have weak CRA performance ratings. What procedures do you have in place to monitor fulfillment of the conditions you set? What action has your agency taken when the institution has failed to meet its pledge? Please provide specific examples of such actions.

When the OCC grants preliminary conditional approval for a corporate application, we do not grant final approval until the bank has satisfied all of the conditions imposed. Satisfaction of the conditions is generally determined by evaluation and verification of written submissions from the banks, and contact with field examiners assigned the supervisory responsibility for the bank. This has been very effective in obtaining improved performance from banks with less than satisfactory records. To date, no denials or other actions have been required due to noncompliance with conditions imposed.

6. The Federal Reserve Board has established specialized examiners with a separate career ladder, and maintains separate regional offices for CRA enforcement. Are you considering adopting such a system? If not, why not?

OCC examiners are trained to supervise all significant banking areas, including performance under CRA. Examiners are not commissioned until they have demonstrated expertise in each area. Although the OCC does not have a formal consumer career path, commissioned examiners are permitted and encouraged to develop expertise in the consumer area.

Examiners electing to concentrate in the consumer compliance area have the necessary training available to do so. We have recently reevaluated our consumer protection training program to address a need for comprehensive training. In addition, advanced consumer examiner training is available for use by our Districts to provide additional training and experience to examiners.

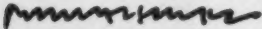
- 4 -

7. Is it an important issue if a bank draws its service area in order to avoid being charged with redlining for terminating services or avoiding servicing lower income Native Americans?

Were an institution to delineate its local community or service area in such a manner as to avoid servicing lower income Native Americans, the OCC would be concerned. An institution's delineated local community is an important element of the overall review of performance under the Community Reinvestment Act. CRA requires that all covered financial institutions must delineate their local community in such a manner as not to exclude or gerrymander out low- to moderate-income neighborhoods. CRA requires national bank examiners to review the reasonableness of delineations. Examiners must be alert to situations where specific areas, including low- to moderate-income neighborhoods with high Native American populations, have been arbitrarily excluded from the delineated area. Such a delineation, if uncovered, may be considered to be unreasonable and would require the bank to provide a sensible rationale for the delineation or to change it.

I appreciate the opportunity to provide the above information. If I can be of further assistance, please do not hesitate to contact me.

Sincerely,



Robert L. Clarke  
Comptroller of the Currency

## ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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"SECONDARY MARKET LENDING PATTERNS"



April 11, 1988

Mr. Barton Naylor  
Investigator  
Committee on Banking, Housing  
and Urban Affairs  
534 Senate Dirksen Office Building  
Washington, DC 20510

Dear Bart:

In response to your request to Annette Fribourg, we have compiled an analysis of our 1987 business data for the zip code pairs you provided. As you discussed with Annette, we are providing this analysis for your background information, and we appreciate your willingness to maintain its confidentiality. In fact, it is only on that basis that we can give you this information at all.

With regard to methodology, we made adjustments to the 1982 income data in order to make a more consistent comparison between the income figures provided and 1987 portfolio purchase data. The adjustments and assumptions we made regarding the income data are detailed in the enclosure.

I would also point out that as we examined the areas represented by the three-digit zip code prefixes, we discovered they are not purely high-income or purely low-income. Thus, our business activity in a three-digit zip code area designated "high-income" could represent significant, even predominant, activity within low-income areas. The converse is also true.

In reviewing this data, please remember that the designated high-income areas generally represent a more highly populated, urban/suburban environment, while the designated low-income zip codes are predominantly rural areas with smaller populations. Rural areas inherently have less housing activity than the more populated, more transient, urban/suburban environments.



Fifty Years of Opening Doors  
for American Home Buyers

Mr. Barton Naylor  
April 11, 1988  
Page 2

FHA, VA, and FmHA loans are also more popular in rural areas than conventional loans. The significant military presence in some of the zip code prefixes suggests higher VA loan activity. I suggest that you also consider the level of government loan activity in these zip code areas in order to obtain a full picture of how housing needs are being met.

Finally, the information we present does not take into account the size of the housing stock. Thus, while we might purchase twice as many loans in location A than B, if A has five times more housing units than B, our relative support of B is greater.

I hope this information is useful to you and that you will not hesitate to contact Annette Fribourg if there is any further information we can provide.

Sincerely,

*Dale*

DPR/rm

Enclosure

#### ADJUSTMENTS AND ASSUMPTIONS

The zip code pairs were intended to reflect high-income and low-income areas, based on 1982 mean Adjusted Gross Income (AGI). The populations for those zip code areas are represented by the number of federal income tax returns for each zip code prefix.

In order to compare our 1987 portfolio purchase data to the 1982 mean AGI, we made a number of adjustments and assumptions. First, we converted 1982 AGI into 1982 Gross Income (GI), because underwriting guidelines are based on gross income. We did this by determining that nationally in 1982 the AGI was 96.6 percent of gross income. Second, we brought the 1982 gross income figures up to 1987 levels by using the rate of income growth in each state. The state rate of income growth does not necessarily reflect the peculiarities of each locality, but income growth rates for localities through 1987 are not available at this time. The state income growth rates are listed below. Third, we assumed in our calculations that the relationship between personal income and gross income remains the same over time. Finally, in determining the affordable loan amount for the computed gross incomes, we assumed the borrower chose a 30-year fixed rate mortgage with a 10 percent interest rate.

#### COMPARISONS

In general, the zip code prefixes do not represent purely high-income or purely low-income areas. Also, the designated high-income zip code prefix generally represents a more urban/suburban environment, while the low-income zip code prefix is a predominantly rural area. In the less populated, more rural areas, loans are more likely to be "government" (FHA, VA, and FmHA) rather than conventional loans. These, as well as the specific factors listed below, account for the difference in the amount of business conducted in each area. Thus, the number of loans and total unpaid balance (UPB) figures should not be considered alone, but rather in the context of the area represented by the zip code prefix. Because of the tendency toward government loans in rural areas and the strong military influence in others, we would suggest examining the volume of FHA, VA, and Farmer's Home activity in these areas in order to assess the total picture of housing needs and how they are met.



FEDERAL  
RESERVE BANK OF  
PHILADELPHIA

Community and Consumer Affairs

April 25, 1988

Mr. Calvin Bradford  
Senior Fellow  
Hubert Humphrey Institute  
of Public Affairs  
University of Minnesota  
Minneapolis, MN 55401

Dear Mr. Bradford:

I have read with considerable interest your prepared testimony for the Senate Banking Committee's recent hearings on the Community Reinvestment Act.

Please be advised that the reference (on page 15) to this Office is materially inaccurate. There is no "rule" such as is reported in the first sentence of the reference. And the following sentence, as well as the concluding comment in the paragraph, are also in error.

It is disappointing to observe these mistakes by a respected source, especially in the context and because they could have been avoided by a simple request for clarification. Moreover, it is misleading to attribute to another statements which have not been made by the person and which are at variance with reality.

Sincerely yours,

Frederick M. Manning  
Assistant Vice President and  
Community Affairs Officer

FPM/bcf



The Color of  
Money

**The Atlanta Journal**  
**THE ATLANTA CONSTITUTION**

May 1-5, 1988

# Atlanta blacks losing in home loans scramble

## Banks favor white areas by 5-1 margin

By Bill Dedman  
Staff Writer

Whites receive five times as many home loans from Atlanta's banks and savings and loans as blacks of the same income — and that gap has been widening each year, an Atlanta Journal-Constitution study of \$6.2 billion in lending shows.

Race — not home value or household income — consistently determines the lending patterns of metro Atlanta's largest financial institutions, according to the study, which examined six years of lender reports to the federal government.

Among stable neighborhoods of the same income, white neighborhoods always received the most bank loans per 1,000 single-family homes. Integrated neighborhoods always received fewer. Black neighborhoods — including the mayor's neighborhood — always received the fewest. The study was controlled so any statistical bias would underestimate the differences between lending in black and white areas.

"The numbers you have are damning. Those numbers are mind-boggling," said Frank Burke, chairman and chief executive officer of Bank South. "You can prove by the numbers that the Atlanta bankers are discriminating against the central city. It's not a willful thing. The banks really are considered the pillars of the community. If somebody walks in and applies, they'll get fair treatment."

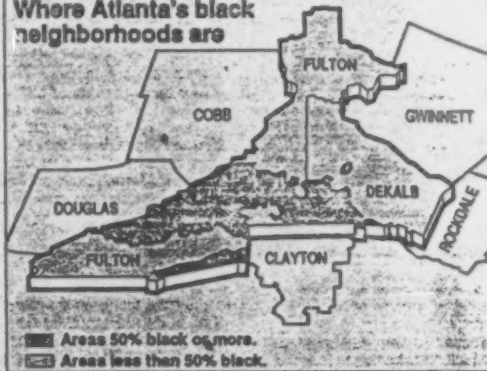
Senior banking executives noted that home mortgage lending is not their primary business. Lenders also said any disparities most likely



### THE COLOR OF MONEY

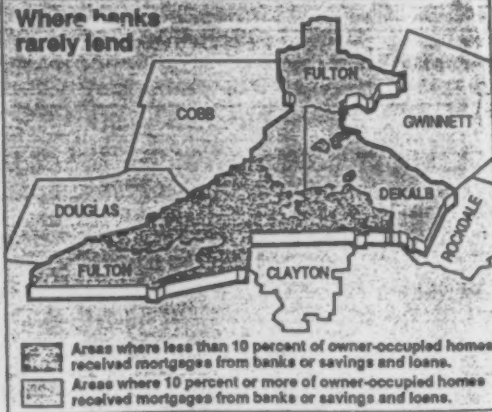
First of four parts

#### Where Atlanta's black neighborhoods are



Source: 1980 U.S. Bureau of the Census figures

#### Where banks rarely lend



Source: Federal Financial Institutions Examination Council figures for 1981-86

are caused by factors beyond their control, including poor quality housing and lack of home sales in black neighborhoods, fewer applications from blacks, and limitations in the federal lending data. They pointed out that lending patterns are influenced by real estate agents, appraisers and federal loan programs.

For example, banking officials said they would make more loans to blacks if real estate agents sent them more black applicants. Real estate brokers who work in black neighborhoods confirmed that they often don't send black homebuyers to banks or savings and loans, but said that is because those institutions have not been responsive and do not solicit their business.

A federal law, the Community Reinvestment Act (CRA) of 1977, says deposit-gathering institutions have an "affirmative obligation" to solicit borrowers and depositors in all segments of their communities.

Federal bank regulators give passing grades to 98 percent of the nation's financial institutions on compliance with the act. But in recent testimony before Congress, heads of the regulatory agencies conceded that they have not enforced the law as well as they should.

As part of a five-month examination of compliance with the CRA, the Journal-Constitution used lenders' reports to track home-purchase and home-improvement loans made by every bank and savings and loan association in metro Atlanta from 1981 through 1986 — a total of 109,000 loans. The study focused on 64 middle-income neighborhoods: In the white areas lenders made five times as many loans per 1,000 households as in black areas.

A companion study of 1986 real estate records for 16 of the neighborhoods yielded similar results: Banks and savings and loans financed four times as many of the home purchases in middle-income white neighborhoods as in middle-income black neighborhoods.

With the banks and savings and loans largely absent, home finance in metro Atlanta's black areas has become the province of unregulated mortgage companies and finance companies, which lenders say commonly charge higher interest rates than banks and savings and loans.

The two lending studies form the foundation of the Journal-Constitution's examination of home finance in metro Atlanta. Among the other findings, which will be discussed here and in subsequent articles in this series:

- Banks and savings and loans return an estimated 9 cents of each dollar deposited by blacks in home loans to black neighborhoods. They return 15 cents of each dollar deposited by whites in home loans to white neighborhoods.

- The offices where Atlanta's largest banking institutions take home loan applications are almost all located in predominantly white areas. Most savings and loans have no offices in black areas.

- Several banks have closed branches in areas that shifted from white to black. Some banks are open fewer hours in black areas than in white areas.

- Lenders are not required to disclose information on loan applicants by race. However, two of the largest lenders volunteered that information, which showed they rejected black applicants about four times as often as whites.

- Meanwhile, a black-owned bank in Atlanta, which makes home loans almost exclusively in black neighborhoods, has had the lowest default rate on real estate loans of any bank its size in the country.

### 'It's institutional racism'

The differences in bank lending to whites and blacks in metro Atlanta did not surprise some government observers.

"I think it's obvious that some areas of Atlanta have more trouble than others getting credit," said

Robert Warwick, vice president of the Federal Home Loan Bank of Atlanta, which regulates savings institutions. "It's perfectly obvious."

"It's institutional racism," said Marvin Arrington, president of the Atlanta City Council. "While we are patting each other on the back about being a great city and a city too busy to hate, they're still redlining."

Redlining is an illegal practice of refusing to lend in certain neighborhoods on the basis of race, ethnic composition or any standards other than creditworthiness. The definition comes from the alleged practice of drawing a red line on a map around certain neighborhoods to designate them as off-limits.

Senior bank executives said they welcome black borrowers. They also point out they have contributed to many efforts to improve housing in Atlanta, from giving money to build Southside houses for blacks in the 1960s, to forming a mortgage loan pool for lower-income homebuyers in the 1970s, to supporting the Atlanta Neighborhood Housing Service effort to redevelop Grant Park in the 1980s.

"It's a myth that banks have a map with a red line on it," said Jim Graham, vice president of SunTrust Banks, the parent of Trust Company Bank. "We don't avoid any area."

"I've never known of anybody redlining areas," said W.D. Hosford Sr., president of DeKalb Federal Savings and Loan. "I believe that any qualified borrower can get a loan today."

"Since the 1950s forward, we've had no prohibitions, no implied rules. We didn't pay any attention to black or white," said Thomas Boland, vice chairman of First Atlanta. "We advertise, 'Please borrow money from us.' We send our mobile information center to the black side of town and on and on and on. If I spent the time and money on the Northside that I've spent on the Southside . . . If you could locate these people . . . It's an imponderable. Somebody's making the loans. It's just not the banks."

## Measuring impact of race

The impact of race on lending patterns was easier to measure in metro Atlanta than in some other cities, since housing patterns almost always follow racial lines here and since Atlanta has a substantial and identifiable black middle class.

The study focused mainly on 64 middle-income neighborhoods: 39 white, 14 black and 11 integrated. Middle income was defined as between \$12,849 and \$22,393 in 1979, the base year for the 1980 census.

The study was controlled to ensure that neighborhoods were comparable in income and housing growth. All judgments about which data to include were made conservatively.

For example, to account for Atlanta's rapid suburban growth, the study excluded any neighborhood that grew by more than 10 percent in the number of single-family houses from 1980 to 1987.

Even with these controls, distinct and growing differences appeared. Banks and savings and loans made 4.0 times as many loans per 1,000 single-family structures in white areas as in comparable black areas in 1984, 4.7 times as many in 1985, and 5.4 times in 1986.

Banking officials, while not questioning the accuracy of the lending figures, offered a variety of explanations for the differences.

Some bankers cited the aging of structures in the city.

"Much of the housing in predominantly black areas is substandard, requiring rehabilitation to qualify for mortgage lending," said Willis Johnson, spokesman for Trust Company Bank. "As a result, this cannot be handled through conventional mortgage lending channels."

Officials at Atlanta's black-owned bank disagreed.

"I have difficulty believing that most of the housing in black neighborhoods is substandard," said Ed Wood, executive vice president of Citizens Trust Bank. "That is where the black community of Atlanta really got its name nationally. Peo-

ple who come from outside are amazed: 'Black folks got these kinds of houses here?'"

Several banking officials also said the difference might be caused by more home sales in white areas.

The bankers were partly right. To check the demand, the newspaper analyzed real estate records of all home sales in 1986 in 16 of the 64 middle-income neighborhoods. Homes did sell twice as often in white areas as in black areas.

Of the homes that were sold, banks and savings and loans financed four times as many in the white areas as in the black areas. In middle-income white areas, banks and savings and loans made 35 percent of the home loans. In middle-income black areas, banks and savings and loans made 9 percent.

Even lower-income white neighborhoods received more of their loans from banks and savings and loans than upper-middle-income black neighborhoods. Lower-income white neighborhoods (those with a median income below the \$12,849 household income in 1979) received 31 percent of their loans from banks and savings and loans. Upper-middle-income black neighborhoods (those above the metro area's median of \$18,355 in 1979) received 17 percent.

In Cascade Heights, where Mayor Andrew Young and other prominent blacks live, 20 home-purchase loans were made in 1986. Of those, two were made by banks and savings and loans, and two by mortgage companies owned by banks. The rest were made by unaffiliated mortgage companies.

## Blacks rejected more often

If sales differences do not account for most of the lending pattern, banking officials said, then the number of applications probably would. However, federal law does not require financial institutions to make public information about applications by race or area.

Only two of the 88 institutions in

the study divulged application figures by race. These figures, from the two largest savings institutions in Georgia, suggest blacks make proportionately fewer loan applications than whites. But they also show that black applicants for home-purchase loans are rejected four times as often as whites.

Georgia Federal Bank in 1987 rejected 241 of 4,990 white applicants, or 5 percent, but 51 of 238 black applicants, or 21 percent. Fulton Federal Savings and Loan, from 1985 through 1987, rejected 1,301 of 12,543 white applicants, or 10 percent, but 363 of 1,022 black applicants, or 36 percent.

Banking officials also said the racial disparities in the study might be caused by limitations in the lending data. The federal records include only loans made directly through the banks and savings and loans, not through mortgage companies owned by the large banks. All but one bank declined to provide information on loans by their mortgage companies.

However, real estate records show that mortgage companies owned by banks rarely made loans in black areas of any income. In white middle-income areas, 20 percent of loans from mortgage companies were made by those owned by banks. In black areas of the same income, the figure was 3 percent.

Finally, banking officials said home lending is not their primary business. Traditionally, banks made most of their loans to businesses, and still often call themselves "commercial banks." A home loan was a favor for a commercial customer.

In recent years, however, changes in federal and state laws have blurred the lines between banks and savings and loans. Banks across the country are doing more home lending. Metro Atlanta's banks now make more than \$1.5 billion annually in home loans, according to 1986 annual reports compiled in an industry directory, Sheshunoff's Banks of Georgia.

## Law requires fair lending

Equitable lending practices are required under the Community Reinvestment Act, which says banks and savings and loans have "continuing and affirmative obligations to help meet the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with safe and sound operation."

The law strives for a balance: Banks and savings and loans should protect the money of depositors and make a profit for shareholders. But the law also says they should seek that profit in every neighborhood.

Banks and savings and loans face this obligation because they receive privileges, particularly government permission to operate and federal insurance of their deposits.

Federal appeals courts have said banking is so "intimately connected with the public interest that the Congress may prohibit it altogether or prescribe conditions under which it may be carried on."

Bankers said they bend over backward to obey the laws, and some said they are eager to make more money in black areas.

"If I could make \$10 million or \$20 million in these loans, I'd make them," said First Atlanta's Boland. "I don't think a black borrower brings me any more risk per se."

First Atlanta placed last in the Journal-Constitution's ranking of 17 banks and savings and loans based on the percentage of home loans made to minority and lower-income neighborhoods. And it placed 12th of 14 institutions in a ranking based on lending to comparable middle-income black and white areas.

Only the city's two black-owned financial institutions, Citizens Trust Bank and Mutual Federal Savings and Loan, made more home loans in black areas than white.

These institutions, although small, appeared not to be suffering for lending mostly to blacks. Citizens Trust had a lower default rate on real estate loans than the six largest banks in the city and the

lowest of any bank its size in the country in 1986, according to the Federal Financial Institutions Examination Council, a government agency that produces reports for bank examiners.

"I don't see our default ratio being any higher because we're working in the black community," said Wood of Citizens Trust. "I wouldn't be in banking if I gave money away."

Several of the institutions that ranked low in the Journal-Constitution lending study capture the largest share of black customers, according to a 1986 market study for the Journal-Constitution. First Atlanta, Trust Company, Citizens and Southern (C&S) and First American, in that order, had more than half the black customers.

In all, metro Atlanta's blacks have an estimated \$765 million deposited in financial institutions. That estimate is made by multiplying the number of non-white households in a 15-county metro area (204,802, according to the U.S. Census Bureau) by national black households' average balance of accounts at financial institutions (\$3,734, according to a 1984 Census Bureau survey).

The banks and savings and loans appear to invest little of black deposits in black neighborhoods, at least in home loans.

In middle-income black neighborhoods, each single-family home received an average of \$339.27 in home-purchase loans from banks and savings and loans in 1986. Using the census estimate of \$3,734 in deposits per black household, that's an estimated 9.1 cents on the dollar in lending.

In middle-income white neighborhoods surveyed, each single-family structure received an average of \$2,432.82 in home-purchase loans from banks and savings and loans in 1986. Using the census estimate of \$17,812 in deposits per white household, that's an estimated 13.7 cents on the dollar in lending — a rate of return 50 percent higher than in the black neighborhoods.

"We're talking about disinvestment, capital flight from the Southside," said Sherman Golden, assistant director of the Fulton County Department of Planning and Economic Development. "When the banks disinvest, the governments also find themselves disinvesting. To accommodate the growth on the Northside, all the public funds flow north. Southside residents put money in the bank and pay taxes, but their money is spent on the Northside."

"We're talking about disinvestment, capital flight from the Southside. When the banks disinvest, the governments also find themselves disinvesting. To accommodate the growth on the Northside, all the public funds flow north. Southside residents put money in the bank and pay taxes, but their money is spent on the Northside."

— Sherman Golden  
Fulton County Planning  
and Economic Development  
Department

## Lower-income also affected

Although the Journal-Constitution study focused on middle-income neighborhoods, the results concern groups working to solve Atlanta's shortage of decent housing for the working class and the poor, regardless of race.

"As long as they won't lend in Cascade Heights, I don't know how we'll get them to lend in Cabbage-town or Ormewood Park or Pitts-burgh or South Atlanta," said Lynn Brazen, a director of the Georgia Housing Coalition, a group that encourages housing efforts.

Neighborhoods say they need investment by financial institutions now more than ever because federal housing aid is rapidly dwindling — from \$33 billion in 1980 to less than \$3 billion in 1987, according to a study by the National Association of Realtors. Atlanta's share of federal housing and community development money dropped from \$8 million in 1983 to \$4 million last year. The city also earmarked half of that money for its tourist-entertainment complex, Underground Atlanta.

With less federal money, neighborhoods searching for other deep pockets have turned to the banks. And Atlanta has some of the most profitable banks in the country.

Last year First Union Corp. of North Carolina and SunTrust Banks of Atlanta, parents of First Union and Trust Company respectively, led all U.S. banks in net income. First Atlanta, C&S and Bank South have consistently been in the top half of their peer groups nationally in profits, according to the federal examination council.

Neighborhood leaders say they don't want to cut those profits.

"We're not asking the banks to do anything that's not banking. We just want them to make money on the Southside too," Mrs. Brazen said.

Without equal access to credit, community leaders say they watch their neighborhoods slide. When people cannot borrow money to buy or fix up houses, property values decline. Real estate agents direct their best prospects elsewhere. Appraisers hedge their bets by undervaluing property. Businesses close. Homeowners sell to speculators.

Homeownership is the linchpin in the American Dream, the main way that families accumulate and hold wealth. Americans borrow against their homes for education, for vacations, for emergencies, for retirement. The family home often forms the bulk of parents' bequest to their children.

White families are more likely than blacks to build that wealth. They own homes more often, and

their homes grow in value faster.

The Census Bureau said in 1984 the income of a typical white family in America was twice the median income of a black family, but the median household net worth of whites was nearly 12 times that of blacks. That's \$39,135 versus \$3,397.

"It takes money to make money. The problem we have in the black community is there is no base with which to make money," said the Rev. Craig Taylor, a white Methodist minister and Southside housing developer.

Redlining and disinvestment were hot issues in the nation's cities in the mid-1970s, when Congress approved disclosure laws and the Community Reinvestment Act.

A decade later, activists claim red lines are being redrawn, and Congress is considering legislation to enhance enforcement of the law.

"Let's face it: Redlining hasn't disappeared," said Sen. William Proxmire (D-Wis.), chairman of the Senate Banking, Housing and Urban Affairs Committee. "Neighborhoods are still starving for credit."





## Ranking lenders on black vs. white loans

Comparing lending to middle-income neighborhoods

| Rank | Institution                         | Black:White<br>Loan ratio |
|------|-------------------------------------|---------------------------|
| 1.   | Citizens Trust Bank *               | All black                 |
| 2.   | Mutual Federal Savings and Loan *   | 5:1                       |
| 3.   | Anchor Savings Bank                 | 1:2                       |
| 4.   | California Federal Savings and Loan | 1:2                       |
| 5.   | Georgia Federal Bank                | 1:3                       |
| 6.   | DeKalb Federal Savings and Loan     | 1:3                       |
| 7.   | Trust Company Bank                  | 1:3                       |
| 8.   | Liberty Federal Savings and Loan    | 1:4                       |
| 9.   | C&S Bank                            | 1:4                       |
| 10.  | Fulton Federal Savings and Loan     | 1:5                       |
| 11.  | Decatur Federal Savings and Loan    | 1:8                       |
| 12.  | First Atlanta Bank                  | 1:16                      |
| 13.  | Home Federal Savings and Loan       | 1:17                      |
| 14.  | First American Bank                 | 1:38                      |

\* Black-owned institution

Sources: Home Mortgage Disclosure Act reports by financial institutions, 1985-86; U.S. Bureau of the Census, 1980; Atlanta Regional Commission census update, 1987.

### How the rankings were determined:

Each lender's service rate — home-purchase loans per single-family structure — was calculated for comparable white and black areas, 53 neighborhoods in all. The ratio shown here is the black rate divided by the white rate. For example, Mutual Federal made 5 times as many loans per structure in black neighborhoods as in comparable white neighborhoods. First American made 38 times as many loans per structure in white neighborhoods as in comparable black neighborhoods. The institutions were ranked before the ratios were rounded to whole numbers.

Loans were counted only in stable middle-income neighborhoods. Loans were excluded in high-income or low-income areas, as measured by median incomes below 70 percent or above 122 percent of the metro area's median income; high-growth areas, as measured by an increase in single-family housing of more than 10 percent since the 1980 census; declining areas, as measured by any decrease in single-family housing; and census tracts with fewer than 500 owner-occupied homes.

All loan figures are an average for 1985-86. Only neighborhoods that were at least 80 percent white or non-white were included.

Loan figures for banks, with the exception of C&S, do not include mortgage companies owned by banks. Other banks declined to provide this information. Without those numbers, First Union Bank and Bank South did not report enough loans for ratios to be calculated.



## Ranking lenders on black, working-class loans

Measurement of bank lending to black and/or low-income neighborhoods

| Rank | Institution                         | Score<br>0-100 |
|------|-------------------------------------|----------------|
| 1.   | Citizens Trust Bank *               | 90             |
| 2.   | Mutual Federal Savings and Loan *   | 80             |
| 3.   | Liberty Federal Savings and Loan    | 21             |
| 4.   | Anchor Savings Bank                 | 18             |
| 5.   | DeKalb Federal Savings and Loan     | 14             |
| 6.   | California Federal Savings and Loan | 13             |
| 7.   | First Federal Savings and Loan      | 12             |
| 8.   | First Union Bank                    | 11             |
| 9.   | Decatur Federal Savings and Loan    | 10             |
| 10.  | Home Federal Savings and Loan       | 9              |
| 11.  | C&S Bank                            | 9              |
| 12.  | Georgia Federal Bank                | 8              |
| 13.  | Bank South                          | 8              |
| 14.  | Fulton Federal Savings and Loan     | 7              |
| 15.  | Trust Company Bank                  | 7              |
| 16.  | First American Bank                 | 7              |
| 17.  | First Atlanta Bank                  | 5              |

\* Black-owned institution

Sources: Home Mortgage Disclosure Act reports by financial institutions, 1985-86; U.S. Bureau of the Census, 1980; Atlanta Regional Commission census update, 1987.

### How the rankings were determined:

Loan information reported by banks and savings and loans for 1985-86 was analyzed by The Atlanta Journal-Constitution and the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota; rankings were determined using a method adapted from similar studies by a researcher at Johns Hopkins University.

The rankings are based on a point system that rewards lenders for loans to minority and lower-income areas. Points were awarded for each loan based on the census tract in which the home was located. Census tracts in the seven-county metro area were categorized by race (white, black and integrated) and income (high income, upper-middle income, middle income, lower-middle income and low-income). White areas are those that are at least 80 percent white; black areas are at least 80 percent black; the rest are integrated.

For example, a lender that made all of its home-purchase loans in poor black areas would receive a 100 score. A lender that made all its loans in rich white areas would receive a 0 score. A lender that made all its loans in middle-income integrated areas would receive a 50 score.

Loans were counted only in stable neighborhoods. Excluded were high-growth areas, as measured by an increase of more than 10 percent in single-family housing since the 1980 census; declining areas, as measured by any decrease in single-family housing; and census tracts with fewer than 500 owner-occupied homes.

Figures for all banks include institutions combined through mergers and acquisitions.

The institutions were ranked before the ratios were rounded to whole numbers. Figures for banks, with the exception of C&S, do not include mortgage companies owned by banks. Other banks declined to provide that information.

# THE ATLANTA CONSTITUTION

For 119 Years the South's Standard Newspaper

1960-1957—James M. Cox Jr., Chairman 1957-1974

Attachment A-2

Jay Smith  
Publisher

Bill Kovach  
Editor

Dennis Berry  
President

Tom Tee  
Editorial Page Editor

Glenn McCutchen  
Managing Editor

Jim Minter  
Senior Editor

PAGE 14A, WEDNESDAY, MAY 4, 1988

## If it's not redlining, prove it

The chairman of a local bank has already said it best: "Those numbers ... are damning," said Frank Burke of BankSouth. "Those numbers are mind-boggling."

The numbers Burke was referring to came from an exhaustive study by The Atlanta Journal-Constitution of home-purchase and home-improvement practices of local banks and savings-and-loan institutions. A series by reporter Bill Dedman showed a disheartening gap in the number of loans received by white residents and black residents from the city's major banks and savings and loans. Not only do the financial institutions shun low-income minority neighborhoods; they neglect affluent black areas. Whites receive five times as many home loans as blacks of the same income.

The study was careful to compare neighborhoods of similar homes, rates of growth and levels of income. Still, the figures are astonishing. Financial institutions return about 9 cents of each dollar deposited by blacks in home loans to black areas. They return 15 cents of each dollar deposited by whites in home loans to white areas.

Only two of the 88 institutions studied agreed to disclose their racial figures on home loan applications. While blacks made proportionately fewer applications for those loans, they were also rejected four times as often as whites by the two institutions.

Banks shouldn't lend money to poor risks, should they? No. But that doesn't appear to be the problem in affluent black neighborhoods. Citizens Trust Bank, a black financial institution, makes the majority of its home loans in black areas. And it has had a lower default rate on real estate loans than the city's six largest banks.

The effect of racially uneven practices

is devastating. Home ownership is the main vehicle by which American families accumulate wealth. The practices of the city's major financial institutions result in a myriad of financial setbacks for blacks: 1) They must go to unregulated mortgage companies, which often charge higher interest rates. 2) They cannot easily get the money to improve their property, so some neighborhoods decline. 3) The tendency of white appraisers to undervalue property in black areas — whether of modest income or high — means that those black homeowners cannot accumulate much equity. That helps explain why the net worth of the typical American white family is 12 times greater than that of the average black family.

If residents of affluent black areas have trouble securing real estate loans, then those in low-income neighborhoods have much more. While the banks shouldn't make bad loans, they do have an "affirmative" obligation, under the Community Reinvestment Act, to help meet the credit needs of their local communities, including low- and moderate-income neighborhoods. Think how much the inner city could contribute to the metro area if it could repair its aging housing stock (adding to the tax base), make homeowners of renters and turn those apartments over to those now homeless.

The problem isn't hard to fix. The chief executive officers (CEOs) of the major banks and savings and loans can call in their loan officers and say they want a drastic increase in their home-improvement and home-purchase loans in black areas. The CEOs can reopen branches in black neighborhoods. They can insist their loan originators court real estate agents who work in black areas. If racism isn't the motive of the current disparities, the CEOs have it in their power to show quickly that it isn't.

5-1-88

Jim Minter, Senior Editor

The Sunday editorial page is prepared by the editorial board of The Atlanta Journal

Attachment A-3

## Redlining: an economic war waged on black communities

**A**tlanta's black neighborhoods are under attack, and under attack from some unlikely sources: the city's most reputable banks and savings and loans. Their artillery is called "redlining." And on the homes and businesses they hit, the effects are devastating.

The economic war on black communities must stop, for no other reason than because it is wrong, and that it drains economic lifeblood from communities that desperately need it.

An in-depth series on redlining begins in today's Journal-Constitution and runs through Wednesday. It ought to spark discussion of ways we can cease the bombing of Atlanta's black communities.

The series is the result of analyzing \$6.2 billion lent by Atlanta's major banks and savings and loans over a six-year period. The facts were gleaned from federal banking records, which were obtained through the Freedom of Information Act. The facts are indisputable: Major banks and savings and loans make few loans and mortgages in black neighborhoods, regardless of income. Overall, banks and savings and loans lend to whites five times as often as to blacks of the same income.

The careful research of staff writer Bill Dedman, who compiled and wrote the series, isolates and explains away factors other than race that could account for banks' uneven lending patterns. Lower income could explain why banks write fewer loans to blacks, but it doesn't: When blacks and whites of similar income are paired, blacks still fare far worse in getting loans.

A bad credit standing also could account for the lending disparity, but fails to: Blacks' creditworthiness is no worse than whites'.

Creditworthiness, income, and other factors Dedman examines could account for lending disparities, but they don't. When those explanations fall to the facts, just one factor remains standing: the color of neighborhoods.

And the economic bombing persists even though blacks deposit some \$765 million a year into banks, much of it into the same institutions doing the redlining. Few of those deposits are making their way back into black communities in the form of home loans. So black neighborhoods are left with fewer funds to improve and increase the value of their homes, and more homes in need of roofs, an exterior paint job, a new porch.

Redlining hits blacks not just in depressed home values and lost profits from sales. Worse is a nefarious transfer of blacks' bank deposits to "safer" loans in other communities. That hemorrhage of black deposits drains the economic lifeblood from black communities — and transfers much of it to white neighborhoods.

A city that's truly too busy to hate will find ways to stop the economic war that's being waged on black communities. Hopefully, our series will spark discussion of ways to do so.

Attachment A-4



ROB NELSON—PICTURE GROUP

A pattern of discrimination that touched even black officials: Lomax in front of property

## The Return of 'Redlining'

An Atlanta bank exposé revives a tindery issue

**T**he Sunday, May 1, edition of The Atlanta Journal and Constitution led off with a shocker. It was the beginning of a series of articles accusing Atlanta's banks of discriminating against blacks. According to the painstaking analysis of computer data provided by the banks themselves, lenders were five times more likely to give mortgage and home-improvement loans to whites than to blacks. The paper quoted an Atlanta mayoral candidate, Fulton County Commission chairman Michael Lomax, who had to approach three banks before he was able to get a \$115,000 home-improvement loan. Lomax asked, "If I, a powerful black elected official, can't get a loan, what black person can?"

The series hit Atlantans hard. Atlanta City Council president Marvin Arrington recalls that when he read the first article on Sunday, "I sat there with my head in my hands, with tears running out of my eyes." The news was especially jarring since Atlanta has built an image as a bastion of good race relations and opportunity for blacks. The timing couldn't be worse. Atlanta hopes to showcase its achievements during the Democratic convention there in July. The series also underlined the fact that "redlining"—denying loans in ethnic neighborhoods—is alive and well, and not just in Atlanta. Similar investigative methods used for the articles have turned up inequities in Chicago, Washington, D.C., Denver and Baltimore. A hot topic in the 1960s and '70s, the issue of redlining had largely died down thanks to federal action and bank efforts to promote minority interests. Despite that progress, a pat-

tern of discrimination persists—a subtle, institutional discrimination that shuts the teller's window on blacks.

Bankers generally deny that racial redlining exists. They say the problems are economic. "Banks are not worried about color of skin," says George Stone, first deputy commissioner of the Chicago Department of Housing. "They're worried about capacity to pay back loans." Still, some lenders concede the result is unfair—and damaging. Lee Sessions, executive vice president of C&S bank, said, "Anything that is perceived as a problem is a problem."

**Few defaults:** The next step is Atlanta's to take: the city has pledged to work with banks to develop better investment in the predominantly black south side of town. If that doesn't work, boycotts could result. City leaders say lawsuits could be in the works and that Atlanta might even pull funds from banks with bad investment records. Arrington hopes that won't be necessary. "We're not here to beat up on anybody," he said at a meeting with bankers. "We're looking for solutions."

It's unclear how much even well-intentioned institutions will be willing to do. Mortgages in some poor urban areas actually have low default rates. But they yield less profit and often require government subsidies to make them work. Still, banks have absorbed much bigger losses on supposedly high-profit ventures like loans to the Third World and to the oil patch. In comparison, equal-opportunity lending looks like a smart investment.

JOHN SCHWARTZ with FRANK S. WASHINGTON  
in Atlanta

Attachment B



October 12, 1987

Alan Fishbein  
 Center for Community Change  
 1000 Wisconsin Avenue, N.W.  
 Washington D.C. 20007

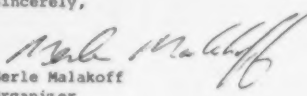
Alan,

Enclosed is a copy of the CRA statement from First National Bank of Commerce (New Orleans) that we discussed on the phone last week. Note that it was written in 1979 and appears to be unchanged since then. To refresh your memory, the interesting thing about this statement is that it does not include home purchase loans, yet the bank is active in the market. The HMDA reports for 1984, 1985 and 1986 show that the bank makes, on average one home purchase loan a week. That data is enclosed as well. If you need copies of the actual HMDA reports just let me know.

The bank called us last Friday to try and schedule a meeting with us, so things are moving forward. Do you have any copies of bank CRA statements that display a more aggressive posture towards CRA? I think that could be useful for us here.

Thanks for your assistance.

Sincerely,

  
 Merle Malakoff  
 Organizer

**Association of Community Organizations for Reform Now**

Organizing and Support Center: 401 Howard Ave., New Orleans, Louisiana 70130 504-523-1691  
 Home Offices: 523 W. 15th Street, Little Rock, Arkansas 72202 501-376-7151  
 National Office: 522 8th St., S.E., Washington, DC 20003 (202) 547-9292

Attachment C



PO BOX 11428  
MEMPHIS, TN 38111-0428  
901-452-6997

Senator William Proxmire  
530 Dirksen Building  
United States Senate  
Washington, DC 20515

February 11, 1988

Dear Senator Proxmire:

I have been informed that you are considering holding hearings in March on the performance of the various financial regulatory agencies in enforcing the Community Reinvestment Act. I would like to offer the recent experiences of the Shelby County Community Reinvestment Coalition in challenging Leader Federal Savings&Loan Association's application to open a new branch in Shelby County, Tennessee. The regulatory agency in question is the Federal Home Loan Bank Board and particularly the Cincinnati District Office.

We have not been happy with the treatment we have received from the FHLBB, and would especially like to bring to your attention five concerns:

#### INCOMPLETE HOME MORTGAGE DISCLOSURE STATEMENTS

The FHLBB allowed Leader Federal Savings&Loan Association to submit inaccurate and incomplete Home Mortgage Disclosure Statements and then allowed them to drag their feet in responding to our requests for complete and accurate HMDS's and to finally deliver the accurate information to us several days before a scheduled oral argument. In Nashville their 1985 HMDS is completely missing.

#### ONE-SIDED BANK EXAMINATIONS

After our Coalition's initial complaint against Leader Federal and a one hour oral argument, the Cincinnati office initiated a "regular examination" of Leader Federal and never bothered to even interview those community leaders who had complaints about Leader Federal's CRA performance.

#### NEW APPLICATIONS ALLOWED WHILE QUESTIONS WERE PENDING

While a decision was still pending on our Coalition's initial complaint, the Cincinnati office of the FHLBB allowed Leader Federal to file three more applications to open new branches even though the regulations are fairly clear in stating that when there are regulatory issues outstanding they should not do so.



page 2  
Proxmire

#### AR FORMS NOT REQUIRED OF SAVINGS&LOANS

Although the regulations clearly mandate that Savings&Loans are to file AR Forms with the regulators and make them available to their members, Leader Federal never has filed such forms, claiming an exemption for institutions which do not have transactions with affiliated parties. Leader Federal clearly has had transactions with affiliated parties and has never been challenged on this by the FHLBB.

#### GENERAL FAVORITISM SHOWN

In our challenges we have found the FHLBB's regulations inconsistently applied to us and to Leader Federal with obvious favoritism shown to Leader Federal.

I would like to expand on some of these points for your further information and also offer you access to copies of the correspondence which will document these problems.

#### INCOMPLETE HOME MORTGAGE DISCLOSURE STATEMENTS

Leader Federal submitted Shelby County HMDS's for 1984 and 1986 which include large portions (over 20% initially in 1986) of their lending in a lump category called "Shelby County" even though Shelby County is thoroughly divided into census tracts and HMDA requires that lending be delineated by census tract. When we called this problem to the attention of Leader Federal and the FHLBB in August of 1987 Leader was allowed to drag out correcting their 1986 HMDS even though there was an oral argument on their CRA record scheduled in Memphis for September 15. We repeatedly made the point to the FHLBB that Leader Federal should be required to fully and correctly present their HMDS before an oral argument be scheduled. Our request was denied by Mr. Lassiter, the Supervisory Agent of the Cincinnati District, in a letter dated September 10.

After the scheduled September 15 oral argument was delayed at Leader Federal's request, we renewed our request for an accurate and complete HMDS and received no support from the Cincinnati office of the FHLBB until suddenly on October 14 two days before the rescheduled hearing date we received from the FHLBB and Leader Federal simultaneously a new copy of Leader Federal's 1986 HMDS labelled "Corrected 9-10-87" which took approximately half of the loans from the lumped category labeled "Shelby County" and redistributed them to various census tracts in Shelby County. This left about 9% of their first mortgage lending still undelineated for 1986. The oral argument was to proceed anyway on October 16 until we protested vigorously that it was totally unfair to change the figures upon which we were building the case for the oral argument so soon before the hearing date.

The oral argument was reset for November 3 with our request that Leader Federal be required to file a completely correct 1986 HMDS in time for us to adequately prepare the charts and analysis of their lending patterns. Days went by and finally on October 29 at mid-afternoon we received a 1986 HMDS which finally appeared to be correctly filled out. Our requests that the November 3 hearing be postponed long enough for us to prepare for the oral argument were denied.

If the 1986 HMDS was the only one in question, this would be bad enough, but the 1984 HMDS has the same lumped category called simply "Shelby County." In addition there are at least two and possibly three versions of the 1984 Leader

page 3  
Proxmire

Federal HMDS in existence. Which one is the correct one is probably anybody's guess. The figures on Leader's 1985 HMDS for conventional loans within minority census tracts are at such variance from the figures for the year before and the year after that it is very doubtful that they are correct. When we asked for a "special investigation" of Leader's HMDS's we were told orally that such an investigation would take place, but later found out that the FHLBB was conducting a "regular examination" of Leader Federal and to this date we still have no assurances that Leader Federal's 1985 and 1984 Shelby County HMDS's are correct. In 1986 Leader Federal first submitted a HMDS which did not include any Home Improvement Lending. When we challenged them on that a HMDS with just Home Improvement Lending appeared several weeks later dated for the same date as the original. Since it is common practice to submit the entire HMDS at once, we can only conclude that Leader Federal goofed and then was allowed by the Cincinnati office of the FHLBB to submit a back-dated HMDS to cover up that fact. With those two versions of Leader's 1986 HMDS, a later copy to merge them, a half-way corrected copy labelled "Corrected 9-10-87" and a final version labelled "Corrected 10-28-87" we have now seen five versions of Leader's 1986 HMDS.

When the Middle Tennessee Community Reinvestment Coalition requested Leader's HMDS's for the Nashville area, they discovered similar problems. Once again much of the urban lending in their area was simply lumped into a category called "Davidson County" even though Davidson County is fully divided into census tracts. In addition the Nashville offices of Leader Federal did not have a 1985 HMDS available upon request. It had apparently been lost or never filed.

#### NEW APPLICATIONS ALLOWED WHILE QUESTIONS WERE PENDING

On the basis of regulations governing the filing of branch office application forms (CFR 12-545.92c) we believe that the FHLBB should not have accepted Leader Federal's three most recent applications to open new branches (December of 1987). According to the regulations:

The Board shall not accept an application if in its opinion the association is not eligible or its policies, conditions, or operations afford a basis for supervisory objection. The Supervisory Agent shall determine that the application is complete, the applicant is eligible, and that as a preliminary matter there is no basis for supervisory objection to the application, before giving direction for publication of notice.

There are a number of unresolved issues related to Leader Federal's Community Reinvestment record which in our opinion should have been the basis of a supervisory objection to the publication of a legal notice concerning these applications. These unresolved issues include:

1. No final ruling by the FHLBB on our previous CRA challenge of a Leader Federal application to open a branch in Cordova, Tennessee.
2. Because of numerous questions about the accuracy of Leader Federal's HMDS statements during the course of our previous challenge, we requested and the FHLBB agreed to a special investigation of Leader Federal's activities. Later they denied that they ever agreed to a "special investigation" but

.. page 4  
Proxmire

questions about Leader Federal's 1984 and 1985 Home Mortgage Disclosure Statements have never been resolved.

Unless the Supervisory Agent already knew how these issues were going to be resolved (we have heard of no resolution), it seems to us that there should logically have been a supervisory objection to acting on these applications until these significant previously raised issues were resolved.

#### AR FORMS NOT REQUIRED OF SAVINGS&LOANS

-According to the Regulations of the Federal Home Loan Bank Board (563.45) each insured institutions is required to transmit a Form AR or Annual Report Form to its members upon request at least 20 days prior to its annual meeting. As a member of Leader Federal Savings&Loan Association I asked for copies of their AR Form on November 18, 1987. I received a reply from Ms. Frances P. Nothorn, Leader Federal's Secretary, in which she maintained that Leader Federal was not required to file a Form AR because of the exemption listed in 563.45(b)(3) which states that Savings&loans which do not engage in transactions with affiliated parties are exempted. Since Leader Federal has clearly engaged in transactions with affiliated parties in recent years I can not understand why they have been exempted from filing these information forms. During the same time frame I received a very unhelpful letter from Mr. Michael Doebereiner of the Cincinnati office of the FHLBB which simply said that Leader Federal had not filed a AR Form and was not required to do so.

#### GENERAL FAVORITISM SHOWN

1. The place for the postponed September 15 oral argument was first set for a hotel owned by a prominent Leader Federal Board member without any input from the Coalition.
2. In a letter addressed to myself on August 25, Kimberly Jackson of the Cincinnati office requested that the Coalition "please submit a list of the individual(s) who will be representing the Coalition at the presentation, as well as a list of the individual(s) who will be in attendance at the oral argument. We would appreciate having the list on or before September 1, 1987." We submitted that list of attenders and presenters on September 2 only to find that Leader Federal was given the opportunity to review our list and comment on it. We were given no comparable opportunity and in fact found out through a September 8 letter from Mr. Ross, Leader Federal's President to Mr. Lassiter that Leader Federal was only at that time assembling its list of attenders. In addition we were denied the right to have additional interested members of the community present at the oral argument.
3. During a September 9 phone conversation, Mr. Tucker of the National office of the FHLBB told me that the Cincinnati office had assured him that there were portions of Shelby County which were untraced (thus excusing Leader's lump sums on their HMDS) in spite of my September 3 letter to Mr. Lassiter which included a map of Shelby County clearly showing all areas traced.

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Proxmire

4. In the public record Mr. Lassiter has taken pains to refer to the September 15 hearing delay as being the result of our request even though that delay was obviously decided on by Mr. Ross and Mr. Lassiter and then conveyed to us as a foregone conclusion. Mr. Lassiter's letter to me dated September 11 begins "In response to your request for an extension of time for the oral argument.... I am rescheduling the oral argument for 9:00 a.m., Thursday, September 17, 1987, at the Wilson World Hotel." The only extension of time I requested related to Leader Federal's inadequate HMDS and that request had already been denied on September 10. It was clearly at either Mr. Ross's request or at the initiative of Mr. Lassiter that the oral argument was postponed, yet Mr. Lassiter for some reason distorted the record to indicate that my request was responsible for the delay. The only logical explanation of this convoluted attempt to change the facts was that it was an attempt to protect Leader Federal from any adverse publicity relating to their request for a delay in the oral argument.

5. The regulations which govern the oral argument process clearly state that the date and time of such oral arguments must be mailed to each participant ten days in advance and that "the Supervisory Agent shall ensure that the time and place of any oral argument is reasonably convenient to the protestants." On September 11 by letter and September 13 by phone call Mr. Lassiter attempted to change the September 15 date to September 17. The September 15th hearing date was postponed because Leader Federal requested a two-day delay in order to meet with us. Mr. Lassiter willingly assented to a two day delay even though the regulations talk very specifically about a written 10 day notice of date, time and place. When we vigorously protested that two day delay (which we construed solely as an effort to throw a Coalition of twelve different organizations off balance by a last minute change of schedule) the hearing was finally postponed further until October 16. We were not informed of the place of the scheduled October 16 hearing until we received an October 9 letter. The place for the November 3 hearing was changed by letter dated October 27. When a Coalition of twelve different organizations has to coordinate its efforts against a constantly moving target (in terms of place of hearing as well as ever-changing HMDS's) it causes a great deal of frustration and confusion. As a Coalition we did not appreciate such crude efforts which seemed very indicative of a one-sided approach by the Supervisory Agent. All in all we do not believe that we have been playing on a level playing field, and we would appreciate any efforts you might make to convince the FHLBB to treat CRA complaints more seriously and fairly.

Thank you for your attention to this matter, I can be reached during office hours at (901) 452-6997 if you have any questions about this material. I am also willing to provide copies of our correspondence with the FHLBB to further document these items.

Sincerely yours,

Hubert Van Tol  
(for the Shelby County Community Reinvestment Coalition)

cc: Senator Jim Sasser  
Senator Albert Gore

Attachment D-1

2109 BULL STREET  
 POST OFFICE BOX 2267  
 COLUMBIA, SOUTH CAROLINA 29201  
 TELEPHONE (803) 799-9668

# **PALMETTO LEGAL SERVICES**



February 26, 1987

Vernon E. Fasbender  
 Director of Analysis  
 Comptroller of the Currency  
 Southeastern District  
 Peachtree Cain Towers  
 Suite 2700  
 229 Peachtree Street, NE  
 Atlanta, Georgia 30303

Re: 86-SE-02-073-South Carolina National Bank

Dear Mr. Fasbender

On behalf of Fairfield United Action, we are formally requesting you to reconsider and reverse your earlier decision not to hold a public hearing in the above referenced matter. In light of our December 24, 1986 submission it should be absolutely clear that the issues raised by Fairfield United Action of racial discrimination and failure to serve the low and moderate income community are substantial and deserve the fullest possible consideration. Fairfield United Action has more than met the burden of providing a prima facie case that South Carolina National has been involved in behavior which makes it an unacceptable institution to expand its service area into this predominantly minority and low and moderate income community.

To deny Fairfield United Action and other concerned parties the opportunity of questioning representatives of the South Carolina National Bank concerning their wholly inadequate and nonresponsive answer to the very serious, factually substantiated complaint violates the Community Reinvestment Act; denies complainants due process; will render any favorable decision with respect to SCN's request for merger arbitrary and capricious and unsupported by facts on the record. South Carolina National fails entirely to provide any factual rebuttal of the statistics which show gross disparities its lending practice with respect to blacks and for loan availability in low and moderate income communities served by South Carolina National.

To deny complainants the opportunity to publicly address these issues would constitute a failure by the Office of the Comptroller

Vernon E. Fasbender  
Page Two  
February 26, 1987

to meet its responsibilities under the Community Reinvestment Act and violate fundamental principals of administrative procedure and due process. The only possible justification for not holding a hearing is if the Comptroller has concluded to summarily reject South Carolina National's request for a merger based upon Fairfield United Action's written submission.

Sincerely yours

*Michael Gregg Pritchard*  
Michael Gregg Pritchard  
Attorney for Complainants

mh

cc Senator Ernest F. Hollings  
Robert W. Jenkins, Esquire  
Anne McClain Johnson, Esquire  
T. Steven Lynch, Esquire



GEORGIA LEGAL SERVICES PROGRAMS  
SAVANNAH REGIONAL OFFICE

115 EAST YORK STREET, 2ND FLOOR  
P.O. BOX 76027  
SAVANNAH, GEORGIA 31402  
(912) 434-1100  
SIST 301-2110

Attachment D-2

September 23, 1987

Mr. Clifton Poole, Deputy Comptroller  
Office of the Comptroller of the Currency  
Southeastern District  
Marquis One Tower, Suite 600  
248 Peachtree Center Avenue, N.E.  
Atlanta, Georgia 30303

Re: Proposed Merger of First Union Bank  
of Savannah into the First Union Corp.  
of Georgia and First Bank of Savannah  
into the First National Bank of Atlanta

Dear Mr. Poole:

This letter is to request a reconsideration of your office's decision not to grant a public hearing in regard to the above matter.

The members of the Savannah Reinvestment Alliance and this office feel that a public hearing is vitally necessary for a number of reasons. For instance, most of the members of our lower income communities cannot afford to come to Atlanta or adequately express themselves in writing. In short, they feel that an oral presentation is their only effective means of communicating their feelings on this matter. In addition, they feel that your office's denial of a public hearing to them constitutes a denial of the equal protection of the law in light of the fact that your office granted a public hearing to a group in Memphis on October 16, 1986. Therefore, we feel that in all fairness, because our group is not different in any respect from the Tennessee group, the denial of a public hearing is patently unfair.

In conclusion, we would urge your office to reconsider this decision and hold a public hearing in Savannah, Georgia. In addition, we are presently gathering signatures from Savannah residents requesting a public hearing and expressing their intent

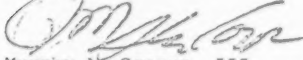
JOHN E. LEE, MARTIN, JR.  
ATTORNEY AT LAW  
MARY A. BURNETT  
TREASURER  
NORMA STANLEY  
VICE PRESIDENT  
CARL BRYANT  
VICE PRESIDENT  
MARY KATZ  
SECRETARY  
CHARLES T. LESTER, JR.  
PRESIDENT

Mr. Clifton Poole  
September 23, 1987  
Page Two

opposition to what they feel was an arbitrary denial of a public hearing. We will send copies of these petitions once they have all been collected.

Thank you for your consideration and I look forward to hearing from you.

Sincerely,

A handwritten signature in dark ink, appearing to read "Murphy A. Cooper, III". The signature is fluid and cursive, with the first name "Murphy" being the most prominent part.

Murphy A. Cooper, III  
Attorney at Law

MAC:mbd

Enclosure

# COMMUNITY REINVESTMENT ACT

**First  
NBC**  
NEW ORLEANS  
First National Bank of Commerce  
210 Baronne Street, P.O. Box 60279  
New Orleans, Louisiana 70160  
(504) 561-1371  
Member FDIC

## COMMUNITY REINVESTMENT ACT STATEMENT

**Delineation of the Local Community of the First National Bank of Commerce.**

The local community of the Bank, for purposes of the CRA, is Orleans Parish, the East Bank of Jefferson Parish and that portion of the West Bank of Jefferson Parish as indicated on the attached map.

**Types of Credit Which the Bank is Prepared to Extend.**

The Bank is prepared to extend the following specific types of credit within its local community:

**Commercial Loans**, including SBA guaranteed loans, account receivable and inventory financing, loans for capital investments in equipment, general working capital and real estate loans to builders and contractors for interim construction of single and multi-family dwellings.

**Consumer Loans**, including automobile, boat, recreational vehicle and other household article secured financing and real estate mortgage secured home improvement loans.

**Credit Card.**

**Form of CRA Notice.**

## COMMUNITY REINVESTMENT ACT NOTICE

The Federal Community Reinvestment Act (CRA) requires the Comptroller of the Currency to evaluate our performance in helping to meet the credit needs of this community, and to take this evaluation into account when the Comptroller

decides on certain applications submitted by us. Your involvement is encouraged.

You should know that:

You may obtain our current CRA statement for this community in this office.

You may send signed, written comments about our CRA statement or our performance in helping to meet community credit needs to Community Reinvestment Act Compliance Officer, Post Office Box 60279, New Orleans, Louisiana 70160 and to the Regional Administrator of National Banks, 1201 Elm Street, Suite 3800, Dallas, Texas 75270. Your letter, together with any response by us, may be made public.

You may look at a file of all signed, written comments received by us within the past 2 years, any responses we have made to the comments, and all CRA statements in effect during the past 2 years at our office located at 210 Baronne Street, New Orleans, Louisiana 70112.

You may ask to look at any comments received by the Regional Administrator of National Banks.

You also may request from the Regional Administrator of National Banks an announcement of applications covered by the CRA filed with the Comptroller.

Adopted by Board of Directors of the First National Bank of Commerce, New Orleans, La.

January 15, 1979  
Reaffirmed Annually

Attachment E-1

**COMMUNITY LEGAL AID SOCIETY, INC.**

Main Office (302) 575-0660  
913 Washington Street, Wilmington, Delaware 19801

October 27, 1987

L. William Seidman, Chairman  
Board of Directors  
Federal Deposit Insurance Corporation  
550 17th Street, N.W.  
Washington, D.C. 20429

RE: Phantom Merger of Delaware Trust Company  
and Interim Delaware Trust Company

Dear Ms. Smith:

I am representing the Delaware Community Reinvestment Action Council ("DCRAC") in a protest that was filed with the New York Regional Office of the Federal Deposit Insurance Corporation ("FDIC") on October 20, 1987, at approximately 9:20 a.m., in regard to an application filed by Delaware Trust Company for a phantom merger with Interim Delaware Trust Company. I am enclosing a copy of the Protest Comments filed on behalf of the DCRAC with the New York Regional FDIC office.

On behalf of the DCRAC, I am formally requesting that the FDIC Board of Directors set aside the approval of the above mentioned application which was made by the New York regional office under delegated authority on October 20, 1987 at approximately 12:45 p.m.

It is my understanding that if a protest is filed with the FDIC before the processing of an application is completed, the application cannot subsequently be approved by a regional office under delegated authority. In the instant case, it is our position that the protest comments filed by DCRAC on October 20, 1987 were filed with the FDIC prior to the completion of the processing of Delaware Trust's application for a phantom merger. Delaware Trust's application was technically approved by the FDIC on October 20, 1987 at 12:45 p.m. after the FDIC received written verification from Delaware Trust of its final publication. Because the protest materials were received by FDIC before completion of the processing of Delaware Trust's application, it appears that the New York regional office should not have approved the application under delegated authority. Upon receipt of the protest materials the regional FDIC office should have forwarded the application along with the protest materials to the FDIC Board of Directors in Washington, D.C., for any further action.

Furthermore, during my telephone conversations with Frank Francisco, Applications Officer, FDIC New York Regional Office, on October 15, 16, and 19, 1987, I informed Mr. Francisco that the DCRAC intended to file written comments on Delaware Trust's application outlining what we believed to be serious violations of the Community Reinvestment Act ("CRA"). In fact, on October 15th when Mr. Francisco informed me that the deadline for filing Comments was on October 15th, I immediately requested a two week extension to accomplish the filing of the Comments. I explained to Mr. Francisco that because the FDIC "Listing of Pending Applications Subject to the



NEW CASTLE CO. Main Office, 913 Washington Street, Wilmington, DE (302) 575-0660  
SCLAP (Seniors), 913 Washington Street, Wilmington, DE (302) 575-0666  
KENT COUNTY 235 S. Queen Street Dover, DE (302) 674-8500  
SUSSEX COUNTY 144 E. Market Street Georgetown, DE (302) 856-0038

Community Reinvestment Act" received by this office does not indicate deadlines for filing Comments, we were unaware of any deadline for filing comments on Delaware Trust's pending application.

On October 16, 1987, Mr. Francisco informed me that my request for a two week extension had been denied. However, he further informed me that under the procedures followed by the New York Regional Office our protest comments would be considered by the FDIC if filed before Delaware Trust's application was processed and approved. Moreover, during a telephone conversation with Mr. Francisco on October 19, 1987, I informed Mr. Francisco that we would be filing Comments on Tuesday morning, October 22, 1987. During our conversation on October 19th, Mr. Francisco also informed me that Delaware Trust's application had not yet been approved.

It is clear that the FDIC had knowledge as early as October 15, 1987, that the DCRAC would be filing protest comments outlining significant CRA violations. Furthermore, because the application was not officially approved at the time the FDIC received our protest materials, it is clear that the subsequent approval of the application should not have been made under delegated authority by the New York Regional Office, and in fact, violated the FDIC's own procedures. In addition, it should be clarified that it is my understanding from Mr. Michael Piracci, Assistant Director of the New York Regional Office, that the FDIC did not consider DCRAC's protest comments prior to approving the application on October 20, 1987.

For the above reasons, we are again requesting that the FDIC Board of Directors immediately issue an order recinding the approval of the application by Delaware Trust to establish a phantom merger with Interim Delaware Trust. Furthermore, DCRAC is requesting that Delaware Trust's application be denied until such time as Delaware Trust provides assurances to the Delaware communities that it will adopt new policies and practices for more effectively carrying out its federally mandated community reinvestment responsibilities in low and moderate income neighborhoods.

If you require any additional information, please do not hesitate to contact me. Thank you in advance for your consideration of our request. I look forward to a prompt response from the FDIC.

Sincerely,

  
MERRIL L. ZEBE, ESQUIRE

MLZ/cls

cc: State Representative James H. Sills, Jr.,  
Chairperson of DCRAC  
John F. Porter, III  
Michael F. Melville,  
Vice-President of Delaware Trust  
Timothy Demurs, Esquire  
Glenn Yeager, Esquire  
Edward T. Lutz, Regional Director,  
New York Regional FDIC Office  
Michael Piracci,  
Assistant Director, New York Regional FDIC Office  
Kenneth Quincy, FDIC, Director of Applications,  
Division of Bank Supervision  
Janice Smith, Office of Consumer Affairs  
bcc: Debbie Goldberg

Attachment E-2

FEDERAL DEPOSIT INSURANCE CORPORATIONRe: Delaware Trust Company  
Wilmington, Delaware

Application for Consent to Merge (phantom)

ORDER AND BASIS FOR CORPORATION APPROVAL

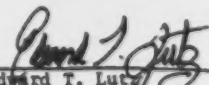
Pursuant to Section 18(c) and other provisions of the Federal Deposit Insurance Act, an application has been filed on behalf of Delaware Trust Company, Wilmington, Delaware, (Operating Bank), an insured State nonmember bank with total assets of \$1,053,893,000 and total deposits of \$906,837,000, for consent to its merger with Interim Delaware Trust Company (New Bank) under the charter of Delaware Trust Company and with the title Delaware Trust Company.

Formation of Interim Delaware Trust Company and the merger transaction are being effected solely to enable a bank holding company (Meridian Bancorp Inc.), to acquire all of the outstanding Delaware Trust Company stock. Following consummation of the phantom merger, Delaware Trust Company will operate the same banking business at its existing locations. The proposal, per se, will not significantly effect the competitive structure of banking in the market served by the Operating Bank. Operating Bank has indicated it will increase services available to its communities including low and moderate income neighborhoods. Emphasis will be placed upon increasing commercial and consumer loan generation, trust services and credit card programs. All factors required to be considered pertinent to the application have been favorably resolved. There have been no protests to this proposal.

The transaction shall not be consummated before the thirtieth calendar day following the effective date of this Order or later than six months after the effective date of this Order, unless such period is extended for good cause by the Corporation. Until the proposed transaction becomes effective, the Corporation shall have the right to alter, suspend or withdraw its approval should any interim development be deemed by the Board of Directors to warrant such action.

By Order of the Regional Director of the New York Regional Office, acting pursuant to delegated authority for the Board of Directors of the Corporation.

Dated at New York, New York, this 20<sup>th</sup> day of October, 1987.

  
Edward T. Lutz  
Regional Director



Attachment E-3

**COMMUNITY LEGAL AID SOCIETY, INC.**

Main Office (302) 575-0660  
913 Washington Street, Wilmington, Delaware 19801

November 10, 1987

L. William Seidman  
Chairman  
Board of Directors  
Federal Deposit Insurance Corp.  
550 Seventeenth Street, N.W.  
Washington, D.C. 20429

RE: Phantom Merger of Delaware Trust Company  
and Interim Delaware Trust Company

Dear Mr. Seidman:

This letter is written on behalf of the Delaware Community Reinvestment Action Council (DCRAC) in response to the November 4, 1987 letter sent to the FDIC by Timothy Demers, counsel for Meridian and Interim Delaware Trust Company.

In the November 4, 1987 letter, Mr. Demers indicates that DCRAC's Protest/Comment was not received in the proper time to be considered by the FDIC. However, the facts clearly show that DCRAC's Protest/Comment was filed with the FDIC before the application was officially approved. I am enclosing a copy of our receipt from Federal Express which indicates that the Protest/Comment was filed on October 20, 1987, at 9:20 AM. Furthermore, the memorandum and attached chronology of events regarding the application, dated October 22, 1987, prepared by Edward T. Lutz, Regional Director, which was sent to Janice Smith, Director of the Office of Consumer Affairs, clearly show that the application was not officially approved until 12:45 PM on October 20, 1987, after the FDIC had received written verification of publication from Mr. Demers.

Mr. Demers further suggests that because DCRAC has been involved in negotiations with Meridian and Delaware Trust as a result of a Protest/Comment filed by DCRAC with the Federal Reserve that the FDIC should disregard DCRAC's Protest/Comment filed against Delaware Trust with the FDIC. Clearly, the FDIC has obligations under its own regulations and procedures to consider any Protest/Comment filed with the FDIC alleging violations of the Community Reinvestment Act and must consider any such Protest/Comment on its own merits regardless of any similar proceedings initiated with another federal regulatory body.



|                       |                                                        |                               |
|-----------------------|--------------------------------------------------------|-------------------------------|
| <b>NEW CASTLE CO.</b> | Main Office, 913 Washington Street, Wilmington, DE     | (302) 575-0660                |
|                       | SCLAP (Seniors), 913 Washington Street, Wilmington, DE | (302) 575-0666                |
| <b>KENT COUNTY</b>    | 235 S. Queen Street                                    | Dover, DE (302) 674-8500      |
| <b>SUSSEX COUNTY</b>  | 144 E. Market Street                                   | Georgetown, DE (302) 856-0038 |

It is DCRAC's position that the FDIC did not comply with its own procedural requirements and erroneously approved Delaware Trust's application under delegated authority despite the timely filing of a Protest/Comment by DCRAC. For the reasons previously set forth in my letter dated October 27, 1987 and as set forth above, DCRAC is respectfully requesting that the FDIC rescind the approval of the application filed by Delaware Trust to establish a phantom merger with interim Delaware Trust and deny Delaware Trust's application until such time as Delaware Trust provides assurances to the Delaware communities that it will adopt new policies and practices for more effectively carrying out its federally mandated Community Reinvestment responsibilities in low and moderate income neighborhoods.

Sincerely,



MERRIL L. ZEBE, ESQUIRE

MLZ/clb

cc: State Representative James H. Sills, Jr.,  
Chairperson of DCRAC  
Timothy Demers, Esquire  
Edward T. Lutz, Regional Director,  
New York FDIC Office  
Janice Smith, Office of Consumer Affairs  
Kenneth Quincy, FDIC, Director of Applications,  
Division of Bank Supervision  
Glenn Yeager, Esquire

**FDIC**Federal Deposit Insurance Corporation  
Washington, DC 20429

Attachment E-4

Office of the Executive Secretary

NOVEMBER 10 1987

CERTIFIED - RETURN RECEIPT REQUESTED

Mr. William C. Lickie  
Chairman and Chief Executive Officer  
Delaware Trust Company  
900 Market Street  
Wilmington, Delaware 19801

Dear Mr. Lickie:

Subject: Delaware Trust Company  
Wilmington, Delaware

The Board of Directors of this Corporation has today rescinded the Order issued on October 20, 1987, by the Regional Director (Bank Supervision) for the FDIC's New York Region approving the application of Delaware Trust Company, Wilmington, Delaware, for consent to merge with Interim Delaware Trust Company, Wilmington, Delaware. This rescission is based on the need to consider a comment filed pursuant to the Community Reinvestment Act.

A copy of the Order evidencing this rescission is enclosed.

Sincerely,

(Signed) Hoyle L. Robinson

Hoyle L. Robinson  
Executive Secretary

Enclosure

## FEDERAL DEPOSIT INSURANCE CORPORATION

Re: Delaware Trust Company  
Wilmington, Delaware

## Application for Consent to Merge (Phantom)

RESCISSION OF ORDER APPROVING APPLICATION

On October 20, 1987, the Regional Director (Bank Supervision) for the FDIC's New York Region, acting pursuant to delegated authority, issued an Order ("Order") approving the application of Delaware Trust Company, Wilmington, Delaware, for consent to merge with Interim Delaware Trust Company. This phantom merger is part of a plan by which Meridian Bancorp. Inc. intends to acquire all the outstanding stock of Delaware Trust Company.

The Order states, in part: "There have been no protests to this proposal." Following the issuance of the Order, it was discovered that a written comment protesting the application had been received shortly before the Order was issued. The comment raised issues relating to the applicant's compliance with the Community Reinvestment Act.

FDIC regulations require the FDIC, in evaluating a merger application, to consider comments received, as well as the applicant's record of performance under the Community Reinvestment Act. Because the comment in question was not filed within the 30-day comment period prescribed in the FDIC's regulations, the FDIC did not consider the comment before formal action on the application was completed. The Board of Directors, in its discretion, has decided that, under the specific circumstances of this case, the Order should be rescinded to permit the FDIC to consider the comment received on October 20, 1987.

Accordingly, it is hereby ORDERED, that the Order dated October 20, 1987, issued by the Regional Director (Bank Supervision) for the New York Region, approving the application of Delaware Trust Company, Wilmington, Delaware, for consent to merge with Interim Delaware Trust Company, is hereby rescinded.

By order of the Board of Directors. Dated at Washington, D. C., this 10th day of November, 1987.

FEDERAL DEPOSIT INSURANCE CORPORATION

(Signed) Hoyle L. Robinson

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By: Hoyle L. Robinson  
Executive Secretary

## Attachment F

[REVISED 3/31/88]SECTION-BY-SECTION SUMMARY  
OF THE CONSENSUS VERSION  
OF CRA ENFORCEMENT AMENDMENTS

[Sponsored by: Mr. Kennedy, Mr. Garcia, Mr. Fauntroy, Mr. Schumer, Mr. Mfume, and Mr. Flake.]

Offered as an amendment in the nature of a substitute to Section 201 of the "Depository Institutions Act of 1988."

Subtitle A -- Community Reinvestment Act  
Enforcement Provisions

Section 201: Short Title: "Community Benefits Amendments of 1988."

Section 202: Findings and Purposes.

Section 203: Amendments to the Bank Holding Company Act of 1956.

(a)(1) The Federal Reserve Board may not approve any of the following applications unless a bank holding company [BHC] achieves a minimum Community Reinvestment rating:

-applications by a BHC to acquire another bank or BHC (except for federally approved acquisitions of troubled institutions);

-applications by a bank to acquire another bank and thereby become a bank holding company (note: this does not include simple bank-bank mergers, which are not governed by the Bank Holding Company Act);

-applications for new powers in securities, insurance, real estate, or any other area in which applications are required under Section 4(c) of the Bank Holding Company Act;

-applications for interstate banking activities under Section 3(d) of the Bank Holding Company Act;

(a)(2) The minimum rating is defined as a "1" [excellent], or a "2" [good]. However, a bank holding company with a "3" [average] rating may have its application approved if it makes commitments to improve in the future (see below).

(b) A BHC with a "3" rating may get preliminary approval of

its application. It then has two years to take actions to improve its rating to a "2" or better. After six months, the Board shall review the BHC to determine whether it has implemented the programs and policies that will enable it to improve its CRA performance within two years.

At the end of two years, the Board shall hold a public compliance hearing to evaluate the BHC's performance and grant final approval of the application.

Note: When the acquisition involves only banks or bank holding companies (i.e. no new non-banking activities) then the Board may approve the application even if the CRA ratings are less than "3", so long as the resulting BHC makes commitments to attain a "good" or "excellent" rating within two years.

(c) No application can be approved if the applicant has established a pattern of opening or closing branches in a manner that tends to exclude low-income areas.

(d) No affiliation of a bank and a securities firm is permitted if it would diminish the availability of credit or deposit services in low-income areas.

(e) A securities firm wishing to acquire a bank with a poor CRA rating may do so only if it makes commitments to improve the acquired banks rating to "good" or "excellent" within two years.

(f) Imputed ratings: The imputed rating of a BHC is the rating assigned to the subsidiary with the least favorable rating, except as provided.

(g-h) Public Notice and Comment: Notice of an application under this section must be published in a local newspaper. The Board is required to accept comments on any application from interested parties. If the Board determines that a comment has raised a substantial issue, it may hold an informal hearing. The Board must make written findings regarding the application.

(i) Any commitments made by the applicant for future performance are required to be made public.

(j) Continuing enforcement: If at any time the applicant BHC receives a CRA rating of "4" [limited effort] or "5" [poor or substantial noncompliance], or if the applicant fails to fulfill commitments to improve, then the Board is required to give the applicant an additional 18 months to improve its performance and fulfill its commitments. If the regular CRA exam after 18 months does not show improvement, the Board shall impose civil penalties proportionate to the size of the institution. [No requirement to divest of the new activities is imposed, but the Board retains its authority to issue cease and desist orders.]



## (k) Definitions.

## Section 204: Amendments to the National Housing Act.

This section applies similar provisions to savings and loan holding companies.

## Section 205: Amendments to the Community Reinvestment Act of 1977.

[Section numbers in this part refer directly to the Community Reinvestment Act]

CRA Section 807: Notice of examinations. The regulators are required to publish notices of all CRA examinations in local newspapers.

CRA Section 808: The regulatory agencies shall collect information regarding the performance of depository institutions in meeting the credit needs of their local communities.

CRA Section 809: The regulatory agencies are required to prepare written evaluations of CRA performance, which must be disclosed publicly. (Currently, all CRA ratings and reports are kept secret - even from the banks themselves.) Sources and sensitive subjects are not required to be disclosed if the judgement of the regulatory agency is that such information should be kept confidential.

CRA Section 810: Each Federal Reserve bank is required to prepare and publish a "community profile" for each community within its district. These community profiles are intended to give an accurate estimation of the specific credit needs of particular communities. CRA evaluations should reflect an institution's record of meeting those specific community needs. (The Federal Reserve has already published detailed and professional community profiles for several communities.)

Community profiles shall reflect the views and comments of local groups, unions, and professionals. The Federal Reserve Bank shall conduct a hearing within each community to solicit the contributions of community groups when developing community profiles.

## CRA Section 811: Performance Rating System.

(a) The regulatory agencies shall jointly develop rating guidelines for assigning numerical ratings under CRA. The goal of the rating process shall be to measure the extent to which the institution is committing financial and managerial resources to community reinvestment activities.

Institutions located in distressed areas, where credit

needs are more extreme, shall be held to an equivalent, but no higher, level of resource commitments as institutions in more prosperous communities.

In developing rating guidelines the regulatory agencies shall solicit public comments.

(b) A numerical rating shall be assigned at the completion of an examination based on the guidelines established under (a) above.

(c) Performance Scale: CRA ratings shall measure the bank's community reinvestment performance on a comparative basis relative to the performance of other banks with similar resources. The rating scale is defined as follows:

- 1 -- excellent
- 2 -- good
- 3 -- average
- 4 -- limited effort
- 5 -- poor or substantial noncompliance

NOTE: This is the same language and the same rating scale that was approved by the Committee as the Oakar-Schumer amendment to the Interstate Banking Act in 1985. The language was substantially changed from H.R. 4022 to accomodate the concerns raised by several Members about creating a "quota system" under which some banks MUST fail. While current levels of performance may imply that some banks OUGHT to fail, this provision does not create an explicit or implicit "quota system." Most banks will probably fall in the good-to-average range, and some will therefore have to commit to improve their performance in the future.

CRA Section 813: In evaluating CRA performance, the regulatory agencies may take into consideration the activities of the parent holding company and the activities of nonbank or nonthrift affiliates which help to meet the credit needs of local communities and low-income neighborhoods.

#### Subtitle B -- Agency Reforms

##### Section 211: Consumer Divisions.

Each of the four federal regulatory agencies (the Federal Reserve Board, the Comptroller of the Currency, the FDIC, and the FHLBB) shall establish a separate "consumer division."

This separate division shall conduct CRA examinations with a trained staff of professional CRA examiners. The consumer divisions shall also respond to consumer complaints, enforce laws regarding consumer protection, access to depository services, equal credit opportunity, and community reinvestment.

(Note: The Federal Reserve already has a separate division of consumer affairs that is responsible for CRA examinations. This provision does not create any new bureaucracy. It simply allocates an existing task to specialized examiners.)

Section 212: Community Review Boards.

Each Federal Reserve Bank shall establish a "Community Review Board." These boards shall be comprised of 16 unpaid members, including 4 bankers, 4 representatives of community organizations, 4 representatives of consumer groups, and 4 representatives of civil rights organizations.

Note: This provision has nothing to do with the "Financial Consumer Associations" proposed by Congressman Schumer in H.R. 4026.



## Federal laws against discrimination 5-1-89

■ **The Community Reinvestment Act of 1977** — Banks have "continuing and affirmative obligations to help meet the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with safe and sound operation."

■ **The Equal Credit Opportunity Act of 1974** — Prohibits discrimination against an applicant for credit because of age, sex, marital status, reli-

gion, race, color, national origin, receipt of public assistance, or efforts to exercise consumer rights. The law requires notification of denial in writing, with the reason specified if the consumer requests.

■ **The Fair Housing Act** — Part of the Civil Rights Act of 1968, it prohibits discrimination on the basis of race, color, sex, religion or national origin in the financing, sale or rental of housing.

### Citizen rights under Community Reinvestment Act

■ Citizens have a right to fair access to credit services, deposit services and other services provided by banks and savings and loans.

■ Citizens have a right to expect a lender to make available a CRA statement, including a map of the community it serves, the types of credit it is willing to extend and the names of federal agencies that regulate the lender.

■ Citizens have a right to submit comments to the public CRA file of a lender and to examine and make copies of comments submitted by others.

■ Citizens have a right to make their credit needs and service needs known to a lender and to expect the lender to respond to their proposals.

■ Citizens have a right to file a formal protest with federal agencies and to request a public hearing in response to a lender's application for a charter, a branch office, a merger, a relocation or an acquisition.

■ Citizens, under the Equal Credit Opportunity Act and the Fair Housing Act, also have the right to sue a lender for intentional discrimination or for lending practices that have a discriminatory effect.

# How study of home loans in metro Atlanta was carried out

The Atlanta Journal-Constitution study of lending patterns tracked home-purchase and home-improvement loans made by every bank, savings and loan association, and large credit union in metro Atlanta from 1981 through 1986.

The newspaper used the federal Freedom of Information Act to obtain the information on computer tape from the federal government, which compiles it from lenders' reports. These institutions are required to report the location of each loan by census tract under the federal Home Mortgage Disclosure Act. The reports were compiled by the Federal Financial Institutions Examination Council, a federal agency.

The newspaper matched the lending data with demographic data from the 1980 U.S. census, updated with 1987 information from the Atlanta Regional Commission.

The study also analyzed federal reports prepared for bank examiners, real estate sales records, market studies and other data, and included interviews with bankers, homebuyers, regulators, real estate agents, appraisers, housing specialists, legal experts and neighborhood leaders.

The study was controlled to ensure that each census tract in the study was homogeneous with regard to race, and that only tracts of similar income were compared.

Regarding race, a neighborhood was not considered to be white or non-white unless 80 percent of its residents were in that group; all other areas were considered integrated.

Regarding income, the 332 census tracts in the metro area were separated into income groups, based on each tract's median household income as compared with the

metropolitan area's median income. These groups were (1) tracts with median incomes above 122 percent of the area median, which were excluded because no non-white tracts had income above that level; (2) tracts below 70 percent of the area median, which were excluded because many of these households would not be able to afford homeownership; and (3) the remaining "middle-income" tracts, which were further separated into three groups of "lower-middle," "middle-middle" and "upper-middle" tracts. (The metro area's median income at the time of the 1980 census was \$18,355.)

In addition, certain neighborhoods were excluded to ensure comparability and so that any statistical bias actually would underestimate the differences between lending to white and black areas.

For example, an area that experienced a great deal of new construction naturally would receive more home-purchase loans than a stable neighborhood. Because most high-growth areas in metro Atlanta are predominantly white, including them would have overstated the discrepancy between lending to whites and blacks. Overall, Fulton and DeKalb counties, where all the predominantly black census tracts in the metro area are located, grew by 12 percent in single-family housing from the 1980 census to 1987, according to the Atlanta Regional Commission. To be conservative, any census tract in the metro area that grew by 10 percent or more during that time was excluded from the study.

The study also excluded six tracts that had shown a loss in single-family housing (most of them around Hartsfield International Airport); 22 tracts with fewer than 500

owner-occupied housing units to begin with; and, because their rates of growth or decline could not be determined, 33 tracts outside the seven-county Atlanta Regional Commission area.

After these deletions, the study focused on 64 middle-income tracts: 39<sup>+</sup> white, 14 black and 11 integrated.

All lending comparisons were based on an estimate from census data of the number of one- to four-family structures eligible for mortgages in each census tract. This estimate was achieved by adding the number of households in free-standing single-family homes or condominiums, half the number of households in duplexes, and the number of households in three- and four-unit structures divided by 3.5.

The Home Mortgage Disclosure Act data that form the basis of the study have limitations.

First, the law requires financial institutions to disclose to the public only the location of actual borrowers. No figures on the number of applicants or the percentage approved are available by race or location. Information about rejection rates of blacks and whites is available to federal regulators, but not to the public.

The Journal-Constitution asked each institution to volunteer information about applicants. Only two, Georgia Federal Bank and Fulton Federal Savings and Loan, the two largest savings institutions in the state, provided the information.

Second, the study could not include every home loan in the metro area, because not all lenders are required by federal law to report their loans. Only banks, savings and loans, and large credit unions are covered by the law.

Therefore the figures leave out loans made by separate mortgage companies owned by banks, unaffiliated mortgage companies, life insurance companies and individuals, which altogether make more than half the home-purchase loans. Congress recently expanded the law to require reporting, beginning with this year's loans, by bank-owned mortgage companies.

Because most banks did not supply these data from subsidiaries and because banks traditionally lend less money on real estate than savings and loans, institutions were not ranked by their volume of lending to minority and lower-income neighborhoods. One ranking was based on comparisons of lending to black and white neighborhoods of comparable income, and the other on the portion of a bank's loans that go to black or lower-income neighborhoods.

To offset the lack of data on applications and on the subsidiary companies, the Journal-Constitution analyzed real estate records for 23 neighborhoods, including 16 of the 64 middle-income neighborhoods, for 1986. These records, compiled by Real Estate Data Inc. and made available by the DeKalb Board of Realtors, identify the seller, buyer, lender, type of loan, loan amount and other information.

In each case these real estate records showed at least as great a disparity between white and black lending as the federal loan data.

Although the study could not include all home loans, it did include 82,610 home-purchase loans and 26,721 home-improvement loans for a total of \$6,241,374,000 in lending by banks and savings and loans over six years.



Bill Dedman researched and wrote series on home loans.

### The people who worked on the series

"The Color of Money" was researched and written over a period of five months by Journal-Constitution staff writer Bill Dedman. A native of Chattanooga, Tenn., Dedman, 27, joined the Journal-Constitution in 1987.

The project was supervised by Hyde Post, assistant city editor for special projects, and copyedited by Sharon Bailey. Dwight Morris, assistant managing editor for special projects, supervised the analysis of lending data.

The statistical analysis used methodology largely de-

veloped by Calvin Bradford and Charles Finn of the Hubert H. Humphrey Institute of Public Affairs at the University of Minnesota. These researchers together have nearly 20 years of experience in the field of community economic development. Research assistance was provided by Stan Fitterman, a graduate student in city planning at Georgia Tech.

The Journal-Constitution also adapted some methods and ranking systems used by researchers at Johns Hopkins University and Temple University.



# A tale of two neighborhoods, one black and one white

By Bill Dedman  
Staff Writer

The Gresham Park neighborhood in south DeKalb County is quiet and neat. The houses are simple starters built after World War II: brick over granite, two or three bedrooms, one bath.

The neighborhood between McLendon Elementary School and the old Scottdale textile mill in north-central DeKalb is slightly older: wood-frame houses, and some brick over granite, two or three bedrooms, one bath.

There are some differences in the people who live in the two neighborhoods. The residents of Gresham Park make a little more money than the residents of McLendon. They are better-educated. They stay in the neighborhood longer.

And most residents of Gresham Park are black. Most residents of McLendon are white.

There is a difference in where they borrow money, too.

In black Gresham Park from 1981 through 1986, banks and savings and loan associations made 25 home-purchase loans in an area that has 1,728 single-family structures, according to federal reports reviewed by The Atlanta Journal-Constitution.

In white McLendon in the same period, banks and savings and loans made 176 loans in a neighborhood of 1,438 single-family structures.

That's a difference of eight times the number of loans per 1,000 households.

Bankers contend that the difference in lending between white and black neighborhoods in metro Atlanta is probably caused by higher turnover in white neighborhoods. Real estate records for Gresham Park, McLendon and 21 other

neighborhoods checked by the Journal-Constitution suggest otherwise.

Turnover in Gresham Park is less than in McLendon — 50 percent less. But, of the homes that are sold, banks and savings and loans finance 31 percent in McLendon, while they finance 4 percent in Gresham Park, according to 1986 and 1987 records analyzed by the Journal-Constitution.

Gresham Park homebuyers receive the other 96 percent of their home loans from unregulated mortgage companies, finance companies, the seller and other individuals, often at higher interest rates than those offered by banks and savings and loans.

Several real estate agents who work in Gresham Park say they have learned not to send black applicants to banks and savings and loans.

"I normally refer to a bank or savings and loan only if the buyer requests it," said Jan Reese, whose "for sale" signs dot the neighborhood. "They are more conservative. They want the strongest, most stable customers. It's a domino effect: If they would do a few, they would get a reputation and we would send them more buyers."

Gresham Park used to be a white neighborhood. In the late 1960s, a few blacks moved into the neighborhood, then a few more, then the rush began.

"The whites were leaving in panic trying to get away from black folks," remembers Pal Chapman of Garden Circle, one of the few whites who stayed. "It's still one of the nicest neighborhoods anywhere. It's not a high-income area, but the blacks who moved in are making more money than a lot of the whites who moved out."

The neighborhood fought the

white flight. A biracial group called South DeKalb Neighbors accused real estate agents of steering whites away from the neighborhood and blacks into it. Residents sued to stop blockbusting, where homeowners are scared into selling because of racial change; they won a judgment, but the racial change continued.

The neighborhood was 88 percent black by the 1980 census, and the Atlanta Regional Commission estimated it was 93 percent black in 1987.

Since the shift, the remaining whites and the new blacks of Gresham Park and all of south DeKalb have claimed they haven't been getting their share of county money. They have argued for more money for their schools. They suspect the banks are avoiding their neighborhoods.

John Whitaker, who is white, represents south DeKalb on the county's Community Development Advisory Council. He tried to help his daughter apply for a home loan in south DeKalb.

"They always find the smallest things that they possibly can to deter you. I've had people at banks to tell me that they don't lend in [ZIP code] 30032 [Belvedere in south DeKalb]," Whitaker said. "You won't get one of them to say it out loud, or they'd lose their job."

Up north in McLendon (ZIP

'They always find the smallest things that they possibly can to deter you. I've had people at banks to tell me that they don't lend in [ZIP code] 30032 [Belvedere in south DeKalb]. You won't get one of them to say it out loud, or they'd lose their job.'

— John Whittaker  
Community Development  
Advisory Council

30033), banks and businesses are investing in the neighborhood. The DeKalb Farmers Market is nearby. MARTA has a new bus garage. Marketsquare mall has been renovated. Several apartment complexes have been added.

The small shopping centers near Gresham Park are not being renovated. Only in the past three or four years have residential builders worked near Gresham Park. And Gresham Park has no new apartments.

There have been people who wanted to do [an apartment complex], but no one would lend them the money," said Mary Dennis, a planner in the county's Community Development Department.

A strong sense of community courses through Gresham Park. Residents proudly note that the Gresham Park Mets won last year's state Little League championship for 5- and 6-year-olds. In 1983, the Gresham Park Athletics made it to the national tournament for 9- and 10-year-olds.

The Athletics' parents raised money for the trip with barbecues and a carwash. And some expenses they put on a VISA card.



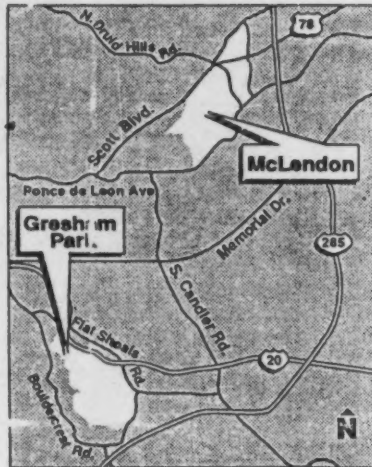
## A look at Gresham Park, McLendon

Gresham Park residents in south DeKalb earn more money, are better-educated and live in newer homes than residents of the McLendon area in north-central DeKalb—but they receive one-eighth as many of their home-purchase loans from banks and savings and loans. One possible reason: Most residents of Gresham Park are black.

|                         | Gresham Park | McLendon |
|-------------------------|--------------|----------|
| % minority              | 88%          | 7%       |
| Income (1980)           | \$19,008     | \$17,222 |
| % high school graduates | 65%          | 60%      |
| % homes owner-occupied  | 93%          | 57%      |
| Age of homes, years     | 23           | 33       |
| Home-purchase loans     | 136          | 170      |
| % by banks, S&Ls        | 4%           | 31%      |
| % by mortgage companies | 68%          | 61%      |
| % by seller, other      | 8%           | 8%       |

Note: Loan figures are for 1986-87. Amounts for home-purchase loans by banks and savings and loans do not include unregulated mortgage companies owned by them.

Sources: Loan data from Real Estate Data Inc., which compiles information on real estate sales from county records. Demographic data from the U.S. Bureau of the Census, 1980.



## Fulton's Michael Lomax: 'If I can't get a loan, what black person can?'

By Bill Dedman  
Staff Writer

When he went to the banks last year looking for campaign contributions for his 1989 race for mayor, Michael Lomax picked up a donation from every one. He wishes he'd done as well when he wanted a loan.

The Fulton County Commission chairman says he had to go to three banks last year to get a loan to add a guesthouse in Adams Park, an upper-middle-class black neighborhood in southwest Atlanta.

"The first reaction from the bank was, 'Why do you want to invest that much money in that neighborhood?' But that's the neighborhood my house is in."

"If I, a powerful black elected official, can't get a loan, what black person can?"

James Fletcher said he couldn't — at least

not from a bank. The 56-year-old retired Southern Railway laborer needed a \$5,000 loan to fix his roof. He owned the house in Mechanicsville, a lower-income black neighborhood in southwest Atlanta.

Fletcher went in 1984 to Citizens and Southern Bank (C&S), his bank for 10 years.

"They said they didn't make no house loans. They didn't let us fill out the papers."

So he and his wife, Lizzie Mae, went to Atlantic Mortgage Co., which loaned them \$5,773.69 at 18 percent interest — plus \$3,180 in "discount points" and other add-ons, raising the effective interest rate to 27.1 percent, according to the loan papers.

Total payback: \$30,722.30.

If C&S had made the loan, at its usual terms of 15 percent interest with five points

LOMAX Continued on Page 14A

over 10 years, the Fletchers would have paid back \$11,764.82.

Fletcher discovered the size of his debt two years after getting the loan. He had paid about \$4,000 and took another couple of thousand in to pay off the rest.

"I don't know exactly how the thing went, but when they got through with it, it was \$30,000," he said. "I guess they can get by with it."

A spokesman for C&S, Dallas Lee, confirmed that Fletcher had been a depositor, but said he could find no record that Fletcher had ever applied for a loan. "It seems highly unlikely [that he would be discouraged from applying]. We make a lot of home-improvement loans," Lee said.

In Fletcher's Mechanicsville neighborhood, C&S made no home-improvement loans and no home-purchase loans from 1984 to 1986, according to federal records. The bank declined to release any information about the number of its loan applicants.

Michael Lomax and James Fletcher are at opposite ends of the same boat. The Atlanta Journal-Constitution's study of lending in metro Atlanta found that banks and savings and loan associations rarely lend to black neighborhoods, from the lowest-income to the highest, from Mechanicsville to Adams Park. Lomax said he hadn't thought he'd have any trouble finding a lender when he started planning a renovation.

"I had remarried, and we decided we wanted to stay in the house. I wanted to add 1,400 square feet in a free-standing building — a guesthouse where we can put people up and I can go hide and where we can entertain. We also were adding air conditioning in the house, a new septic tank field and some landscaping."

An associate professor of literature at Spelman College and one of the two leading candidates for mayor of Atlanta, Lomax has a family income "between \$50,000 and \$100,000 a year ... and I pay my bills." He also has money in the bank but declined to provide specifics.

Lomax wouldn't name the banks

that turned him down, but he did say one of them was where he had banked for 25 years.

County deed records show he received the loan from First Union Bank for \$115,200. Lomax said he has the ability to pay the money back, although he may never recoup his investment.

"My home to date does not appraise for the amount I've invested in it. With a new guesthouse my appraisal went up only \$8,000. I find that extremely frustrating and somehow just plain wrong. I'm not doing anything different from what people do in Morningside or Peachtree Park. You drive through Peachtree Hills and you'll see the exact same houses as in Adams Park, but they're appraised at a third more because white people live in them. Perhaps I'm wrong, but I think I've done the right thing. Since I made my investment, three other homes on my block are being added to."

Banks and savings and loans lend less often in Adams Park than in white neighborhoods of similar household and housing growth, according to real estate records studied by the *Journal-Constitution*.

In 1986, banks and savings and loan associations financed 17 percent of the home purchases in the census tract that roughly corresponds to Adams Park. They financed 37 percent of the home sales in comparable white neighborhoods.

Banks sometimes make home-improvement loans for more than \$120,000 in southwest Atlanta's highest-income black neighborhoods — at least, the black-owned banks do.

According to federal lending records for 1986, the black-owned Citizens Trust Bank made a home-improvement loan for \$156,000 off Cascade Road near Lomax's neighborhood. Black-owned Mutual Federal Savings and Loan made one in the same neighborhood for \$144,000, in integrated East Point for \$134,000, and in integrated southwest Fulton County for \$175,000.

No white-owned institution reported a home-improvement loan of more than \$120,000 in a predominantly black neighborhood in 1986. They did make larger home-improvement loans in more affluent white neighborhoods. For example, in 1986 Citizens and Southern made home-improvement loans in Druid Hills for \$128,000 and in north Dekalb for \$133,000.

"If my house were lifted up and put into any neighborhood in northeast Atlanta, with my family income I would have absolutely no difficulty getting a loan to rehab my house," Lomax said. "But I don't want to move. I like my acre of land and my little bungalow. I can look out my window on a park and a golf course behind it."

"What I tried to explain to the lenders was, I'm pioneering. It's an economically mixed neighborhood, but our income levels in Adams Park are higher than some of the intown neighborhoods where they make loans. On my street are the senior black executive at Coca-Cola, myself, two architects and at least one lawyer. We are restrained by the financial institutions from improving our neighborhood."

Lomax attributed his rejections to lack of understanding by bankers.

"I think that, for most Atlanta banks, black continues to equal high risk in their perceptions. It's an educational issue that we need to work on. In the 1970s they didn't want to lend in Virginia-Highland and Morningside, either. They learned they can make money there."

"If we want to see balanced residential development on the Southside, the banks are going to have to evolve aggressive programs to assist black families in acquiring property. Central Atlanta Progress encouraged such a program for Inman Park and Virginia-Highland. Where is the comparable program on the Southside? I think it's in the best interest of the banks to support that. We want a city of strong neighborhoods where home values increase and not decrease."

Lomax says he isn't mad at bankers and doesn't want to increase regulation of them. He even invited several senior bank executives to his Christmas party, the one he threw in his new guesthouse.

"The ones who came to the party weren't loan officers."

# Poor may be left behind by bank deregulation

## Basic services lagging as institutions court the wealthier clients

By Bill Dedman  
Staff Writer

Ma Bell isn't Ma Bell anymore. And the airlines aren't the same. Quietly, banks also are changing.

It's called deregulation.

Deregulation means banks are becoming larger and are more likely to be headquartered in another city. Deregulation means banks are changing their services to appeal more than ever to wealthier customers. Deregulation means banks are offering checking accounts with interest but also restricting access to basic services.

Some neighborhood groups in Atlanta and around the country think these changes are bad news for consumers, particularly the poor.

It started in 1980, when Congress began to remove limits on the interest that banks could pay depositors.

To compensate for the higher interest rates they began to pay on NOW accounts and Super-NOW accounts and others, banks began to charge for services that had been free and to raise the cost of those that had been cheap. Minimum balances were set even on accounts that earned no interest, according to a 1987 report by the General Accounting Office (GAO).

Many low-income people don't have enough money in the bank to benefit from the higher interest rates, and they can no longer afford the fees and higher balances, according to the GAO report.

The GAO also said banks and savings and loans were charging higher fees for check printing, for stopping payment on a check and for returned checks.

People who can't afford a bank account still have bills to pay. And some businesses won't

take cash. For example, the Atlanta Housing Authority, landlord for 15,000 low-income households, has required tenants to pay by check or money order since 1986.

The poor still have paychecks and government checks to cash, too. In 1977, 99 percent of banks cashed government checks for non-depositors, but only 56 percent did in 1985, the GAO reported.

A federal law, the Community Reinvestment Act, requires banks and savings and loans to help meet the deposit and credit needs of all segments of their communities.

Congress is expected to consider bills this summer to make the requirement more concrete. Banks and savings and loans would be required to offer low-cost "lifeline" checking accounts requiring no more than \$25 for an initial deposit, having no minimum balance requirement, allowing eight free checks and five free withdrawals a month, limiting fees for bounced checks or stopped payments to \$5 apiece.

In addition, banks would be required to cash, at no charge, Social Security, welfare and other government checks for non-depositors.

In the House, the bills will be considered by the Committee on Banking, Finance and Urban Affairs, of which Rep. Pat Swindall, a Republican from metro Atlanta's 4th District, is a member.

Most banks in the country offer some form of low-cost checking to senior citizens and some offer it to students, but only 15 percent offer the service to the general public, the GAO said. Many banks advertise checking accounts as low-cost, but these accounts often do not meet the government's definition of a lifeline.

For example, many Atlanta banks require a minimum balance, usually \$400 or more, to avoid a higher service charge. Those without minimum balances limit the number of checks, usually to 15 a month, and some don't return canceled checks to the customer. The most economical account offered by a large bank in Atlanta is at Citizens and Southern Bank (C&S), where 75 cents buys seven checks a month but no automatic return of canceled checks.



Many low-income Atlantans have no checking account. Of residents with annual incomes below \$15,000, the number without checking accounts may be 46 percent, according to a market study done last year for Trust Company Bank and a neighborhood coalition.

Use of all bank services was less among blacks. Sixty-eight percent of whites in low-income neighborhoods had a savings account, but only 52 percent of blacks. Forty-six percent of whites had an automatic teller card, but only 34 percent of blacks. Fifty-two percent of whites had a VISA or MasterCard, but only 25 percent of blacks.

The market study showed that 42 percent of Atlantans who had no checking or savings account cashed checks at a financial institution anyway; 21 percent went to a grocery store; 9 percent to a check-cashing service; 7 percent a liquor store; 3 percent a furniture store; and 2 percent their employer. The rest named other places, said they didn't know, or said they didn't cash checks.

Check-cashing services can be expensive — from 1 percent to 10 percent of the value of the check, the GAO said. Atlanta services say they charge from 1 percent to 2 percent of payroll checks, more for other types of checks. Some won't cash personal checks.

"Poor people go to the check casher, the pawn shop, the grocer, to cash a check. These are their bankers," said Dennis Goldstein, a lawyer at Atlanta Legal Aid Society. "My dad took

me down to the bank to open a savings account when I was a kid. It took 10 years for my balance to get over \$100, and when I was a teenager I must have written three checks a month. But eventually I'm going to make the bank a profit. Banks don't seem to want that anymore."

The GAO study found that these changes in depositor services were most pronounced at large banks. Now there are more large banks than ever.

New laws allowing interstate bank mergers have made the local neighborhood bank a fond memory in many areas. All six of the so-called Southern superregional banks have Atlanta offices, but only two are headquartered here.

Bankers say interstate banking is more efficient and will bring better services and lower prices to consumers.

Neighborhood groups fear that out-of-state banks will pay less attention to local customer needs, will have fewer familiar faces or will shift local deposits away from the neighborhoods.

Financial officers said getting banks to re-channel a natural inclination to follow only the safest investments, with the highest possible return, is like asking a leopard to change its spots.

"Bankers traditionally have worked with the more affluent areas that have more income and more money," said Bob Thompson, executive vice president of Liberty Mortgage Corp., a subsidiary of Liberty Federal Savings and Loan. "That will never change."



# Southside treated like banks' stepchild?

**Blacks may shun some home-loan lenders because they're shunned first, critics say**

By Bill Dedman  
Staff Writer

James Gray is black and he sells real estate for Century 21 on Cascade Road in southwest Atlanta, an area that includes some of the richest black neighborhoods in Atlanta, including the mayor's.

"Banks and savings and loans: We don't use them," Gray said. "First of all, they don't solicit us. Banks and savings and loans do not have loan officers out looking for business. They don't solicit in white areas, either."

But they do. Loan originators

from banks and savings and loans "come by every day" at the Century 21 office in Alpharetta, said broker Richard Blalock. He is white, and Alpharetta is almost entirely white.

Where the banks look for business is one of many factors that help explain the results of an Atlanta Journal-Constitution study of lending. The study found that Atlanta's banks and savings and loan associations rarely make home loans in black and integrated areas, even the highest-income black areas.

Some other possible explanations of the study results:



■ Most black Atlantans live on the Southside. The Southside mortgage office for Citizens and Southern Bank (C&S) is in Fayetteville — 20 miles south of Atlanta. The Southside mortgage offices for Trust Company Bank and First Atlanta are also south of the Perimeter. These three banks, the largest in Georgia, take applications and close loans only at the mortgage offices, not at branch banks.

■ Several banks have closed

branches in black and integrated areas. In 1986, Trust Company closed its branch on Wesley Chapel Road after the area shifted from white to black; in Belvedere, which was becoming blacker; and in black East Atlanta, although it kept open 23 branches in white areas with less in deposits. Bank South replaced its South DeKalb branch with an automatic teller machine.

■ Many banks keep their branches in black and integrated areas open less often than in white areas. Bank South, for example, advertises that it is open on Saturday to give "the personal attention you deserve." Bank South is open on Saturday in Alpharetta and Snell-

**BANKS** Continued on Page 4A

ville, but not in East Atlanta or the West End.

■ Some Atlanta banks won't consider home-loan applications for loans of less than \$40,000. A lot of homes on the Southside sell for less.

Courts have found similar practices in other cities to be violations of the federal Fair Housing Act and the Equal Credit Opportunity Act, which forbid discrimination in lending based on race or color. Courts have said discriminatory effect, not just discriminatory intent, is enough to prove a violation.

#### 'Not a charitable institution'

Atlanta bank officials say their lending practices are not discriminatory. They say something else, too.

"We are not a charitable institution," said Willis Johnson, spokesman for Trust Company. "We are not the United Way."

Federal law encourages banks to seek a profit. It also says they have a "continuing and affirmative obligation to help meet the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with safe and sound operation."

That last phrase, "consistent with safe and sound operation," brings into play one of banking's basic principles.

"It's called the First Rule of Banking," said James Wallace, vice president of Fulton Federal Savings and Loan. "Don't lend money if you won't get it back."

It has a corollary, the Second Rule of Banking: "When in doubt, don't."

Don't lend more than borrowers are able to pay. In case they don't pay it back, don't lend more than can be recovered by foreclosing and selling the property. Don't lend \$100,000 on a \$60,000 house. And don't lend \$40,000 on a \$50,000 house in a neighborhood so bad that the house may someday be worth only \$38,000.

In effect, lending money to homebuyers is an expression of faith — faith in the borrower, faith in the property, faith in the neighborhood.

In the United States, such questions of lending faith historically have been influenced by race. That influence used to be easily defined — with a list.

In 1933, a respected economist at the University of Chicago, Homer Hoyt, published a list of racial groups, ranking them from positive to negative influence on property values:

1. English, Scotch, Irish, Scandinavians.
2. North Italians.
3. Bohemians or Czechs.
4. Poles.
5. Lithuanians.
6. Greeks.
7. Russians, Jews (lower class).
8. South Italians.
9. Negroes.
10. Mexicans.

The next year, Hoyt was hired by the federal government to develop the first underwriting criteria — who is a good credit risk and who is not — for the new Federal Housing Administration (FHA). His list wasn't included, but warnings on racial influence were.

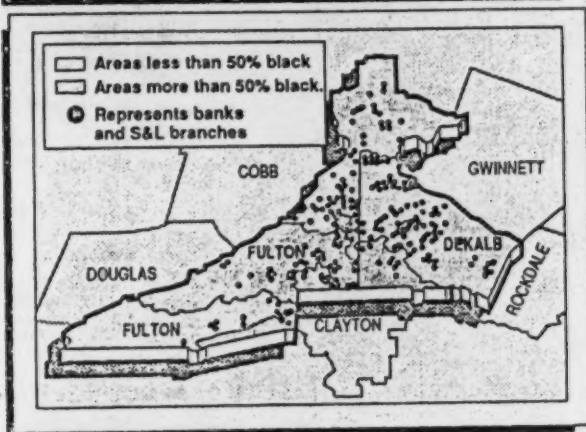
The same views were included in the first text of the American Institute of Real Estate Appraisers in 1933, which warned appraisers of the harm to property values caused by the "infiltration of inharmonious racial groups." The list appeared in the bible of appraising, McMichael's Appraising Manual, as late as 1975.

Appraisers were not alone. The prevailing racism in society was institutionalized in the rules of bankers and real estate agents as well. The National Association of Realtors developed a code of behavior forbidding members from selling homes in white areas to minority buyers.

These racial views persisted through the civil rights era. Publications from the U.S. Department of Housing and Urban Development (HUD), the parent of the FHA, re-



### Location of bank and S&L branches



DAVE WINK/Staff



### Where blacks bank

Ranking banks by share of non-white customers

| Institution                         | Share of non-whites | Non-white customers |
|-------------------------------------|---------------------|---------------------|
| 1. First Atlanta                    | 31%                 | 124,500             |
| 2. Trust Company                    | 28                  | 113,000             |
| 3. C&S                              | 27                  | 106,800             |
| 4. First American                   | 13                  | 50,600              |
| 5. Georgia Federal                  | 12                  | 47,700              |
| 6. Bank South                       | 10                  | 38,200              |
| 7. Fulton Federal Savings and Loan  | 7                   | 28,400              |
| 8. Decatur Federal Savings and Loan | 7                   | 28,000              |
| 9. First Union                      | 7                   | 26,300              |
| 10. Anchor Savings Bank             | 1                   | 2,200               |
| 11. Other banks                     | 13                  | 52,100              |
| 12. Credit unions                   | 9                   | 36,800              |
| 13. Other savings and loans         | 6                   | 22,000              |

Note: Adults in an 18-county metro area were asked what financial institutions they had used for any service; not including automatic teller machines, in the past year. Percentages add to more than 100 because many people said they used more than one financial institution. Numbers of customers are projected from the sample. The black-owned institutions, Citizens Trust Bank and Mutual Federal Savings and Loan, are included among other banks and savings and loans.

Source: The Scarborough Atlanta Market Study for The Atlanta Journal-Constitution, 1986. Based on 1,461 telephone interviews.

DAVE WINK/Staff

flected Hoyt's views as late as 1975. In that year, "The Dynamics of Change," a HUD publication, defined racial change, or the fear of racial change in nearby neighborhoods, as the most significant predictor of "incipient decline."

As late as 1977, it took a lawsuit from the U.S. Justice Department before such racial standards were purged from guidelines of the Society of Real Estate Appraisers, the Mortgage Bankers Association of America, the American Institute of Real Estate Appraisers and the United States League of Savings Associations. Appraisers opposed the settlement, contending their right to free speech was abridged if they could not consider the effect of race in their appraisals.

Real estate is still essentially a white person's business — selling it, appraising it, insuring it, financing it. Ninety-five percent of the officials, managers and professionals at real estate companies in metro Atlanta are white. At savings and loans 90 percent are white. At banks and insurance companies, 87 percent, according to the latest figures (1985) from the federal Equal Employment Opportunity Commission. Most appraisers in Atlanta, at least 80 percent, are white too, appraisers say.

Bankers say they have tried to hire more minority employees.

"We make a steady effort to make sure we're hiring officers in sufficient supply to make sure the numbers come out good," said Thomas Boland, vice chairman of First Atlanta.

Most senior bank executives interviewed for this article said differences in lending to black and white neighborhoods in the Journal-Constitution study can be explained by factors beyond their control — such as a lack of applications.

"The Realtor usually guides them," said Bill VanLandingham, president of C&S. "If they don't refer the homebuyer, we can't make the loans."

Real estate agents in black neighborhoods, however, said they

usually don't refer homebuyers to banks and savings and loans. One reason is that the banks don't come around looking for business.

Ruben James is black and he works in predominantly black south DeKalb County for Precision Realty. "I haven't seen anybody from a bank in a couple of years. There used to be a woman from C&S who came by this office, but I haven't seen her in a long time."

Teresa Jones said bankers don't figure much in her business, either. She is black and she sells houses in predominantly black areas of south DeKalb for Century 21. "Bankers — those are types who just sit at a desk and wait for somebody to come in. They're not really in the mortgage business, are they?"

Bank officers said that almost all of their loan originators — the salespeople who drum up loans — are paid on commission. A good originator will notice two things: First, more homes are sold in the mostly white areas than in black areas. Second, homes in white areas usually cost more.

Two \$50,000 houses mean \$100,000 in sales. One \$100,000 house means the same profit — and half the work.

"A loan originator is going to go where he can make the most money for the least work," said Wilbur Kurtz III, senior executive vice president of Decatur Federal.

Most big banks don't make smaller loans at all. Several make no loans below \$40,000, and others charge additional fees below that amount.

Donald Cullins, 34, a black disabled Vietnam veteran, pays rent on a fixed income in the Pittsburgh neighborhood on the Southside. The home next-door was offered for sale at \$25,000. Just before Christmas he received a certificate of eligibility from the Veterans Administration and went to C&S for a VA loan. He said he was told C&S has a minimum loan amount of \$30,000.

"The funny thing is, I'm paying \$380 in rent right now. The man said, if he could have made me the

loan, my payments would have been \$280 a month," Cullins said.

C&S officials say they have no stated minimum loan amount, "but the reality of the situation does in fact define a minimum," said a C&S spokesman, Dallas Lee. Below about \$30,000, because of fixed costs, "it can become not an economically sound situation."

### Fewer bank branches

Real estate agents also say their black customers have a preference for a bank or savings and loan less often than whites. Community groups say that's because banks avoid black and integrated neighborhoods.

Fifty-two percent of Fulton County residents are black, but 82 percent of the 208,089 residents who live in census tracts without a bank branch are black.

Trust Company, which closed its East Atlanta branch, maintained in a letter to the Federal Reserve Bank of Atlanta that it was "a sound business decision" because the community had failed to "pull itself together and improve."

The East Atlanta branch was located in census tract 209, which was 88 percent black in 1987. In 1985 and 1986 combined, Trust Company made no home-purchase loans and eight home-improvement loans totaling \$35,000 in the census tract, which has 2,215 single-family households, according to the bank's reports to the federal government.

"The East Atlanta branch had been unprofitable for eight years and was located in a neighborhood which continues to experience decline," Trust Company told the Federal Reserve Bank last year. "Most of the local merchants and many of the branch's customers have moved out of this area. The area has experienced such an alarming increase in crime that the branch hired off-duty Atlanta SWAT policemen to replace the usual bank guards."

As for branch hours, the chair-

man of Bank South, Frank Burke, said he was not aware that his branches in black areas were closed on Saturday. He said he is mindful of the Community Reinvestment Act.

"The CRA doesn't say you have to lend to black folks. It says low- and moderate-income. We have tried very diligently to listen to community groups, even though we don't have the branches in the neighborhoods that the other banks do."

Even if a borrower prefers a bank, real estate agents see a difference of convenience.

"The mortgage company man, he'll come see you at the office or at the home after 6 p.m. The bank, a working man's got to take a half-day off to go see the bank," said agent James.

Beth Williams, the receptionist in the Southside office of C&S Mortgage in Fayetteville, said, "If our mortgage officer were to leave, he'd have to travel an hour for an appointment and travel an hour back. If he stays here he can do three appointments in that time."

The Georgia production manager for C&S Mortgage, Jack Johnson, said its mortgage offices are outside the city of Atlanta "because there's just not enough volume there to justify putting in an office."

Some bankers acknowledged that location could be a problem.

"If you're on Campbellton Road and you call and they say, 'Go on up to Galleria,' that could have some effect," said First Atlanta's Boland. "It may be as simple as that. Maybe we haven't realized that."

Bank officers said it would not be feasible to accept mortgage applications at all banks, since the applications are so complicated.

When black applicants do get to a bank or savings and loan, they're more likely to be turned down, several real estate agents who work with black clients contended.

Banks and savings and loans are required to report their rejection rates for blacks and whites to the federal government; they are not re-

quired to disclose the information to the public. But two of the largest savings institutions in Georgia did volunteer that information to the Journal-Constitution for all their offices statewide. Georgia Federal Bank rejected black applicants 4.2 times as often as whites in 1987. Fulton Federal Savings and Loan rejected black applicants 3.6 times as often as whites in 1985-87.

"That could only be explained by a lack of ability to qualify for the loan," said Don Stout, senior executive vice president at Georgia Federal.

"Those are statewide figures. It may be that older properties in some of these rural neighborhoods are not able to qualify for a loan," said Shepherd Marsh, executive vice president of Fulton Federal. "Our underwriters don't look at the color of the applicants."

The rejection rates tell nothing about the creditworthiness of those who applied. However, many real estate agents said they don't refer homebuyers to lenders unless they can qualify at least on the two most important lending criteria: income and debt. Some agents also have lenders check a homebuyer's credit history before an application is made.

"The first thing we do is pre-qualify them," said Precision Realty's James. "Otherwise we're wasting our time, everybody's time."

### Appraisals may be sand trap

If black applicants succeed in getting themselves approved for a home loan, they still have to get the property approved. That brings in the appraiser, who is hired by the lender to make sure the property is worth enough to cover the loan. Appraisers also said they don't look at race anymore.

Willie Clyde isn't so sure. He's a real estate agent on the Southside, he's black, and he had a house to sell. He almost sold it last summer — he had a buyer and a signed contract. Then the buyer went to a bank, whose appraiser came down

from the Northside.

"He called me and asked for directions. He said he didn't work down here that often," Clyde said. "I knew that was trouble."

Clyde bought and remodeled the house, at 53 Bisbee Avenue off Jonesboro Road in South Atlanta. It's an older neighborhood, mostly black, with a lot of vacant houses and a lot of houses being renovated.

"I showed him that we had put on a new roof, that we had redone the interior walls, sanded and varnished the floors, added a sunroom, new plumbing, cabinets, rehabbed the bathroom, rescreened the front porch, new paint. He didn't say anything negative when he came out."

The appraisal came back at \$28,000, about 25 percent less than the contract price of \$38,000. Clyde lost the deal.

"They just don't trust the neighborhood," Clyde said.

He later found another buyer, who chose a mortgage company not affiliated with a bank or savings and loan. Its appraiser said the property was worth \$38,000.

Willie Clyde's first appraiser wrote nothing on his appraisal report about race.

"A conscientious appraiser will forecast property values as best he can, but to avoid liability he might not attribute it to race," said Jim Verner, who teaches appraising at Georgia State University and serves on the curriculum committee of the American Institute of Real Estate Appraisers. "He might attribute it to something more bland — 'wearing out of the public infrastructure' — something that isn't such a dangerous area."

Underappraisals — called lowballs — do more than discourage sales. By definition, they lower property values. Appraisals not only judge the market, they help set it.

The effects can show up in how fast homes appreciate in value.

The median sale prices of homes in Atlanta increased by 58 percent from 1975 to 1984, according to the city Bureau of Planning. Prices increased by 68 percent in

white Garden Hills, but by 20 percent in black Cascade Heights; 84 percent in white Sherwood Forest, but 26 percent in black Adams Park; 71 percent in white Peachtree Hills, 6 percent in black Collier Heights.

Low appraisals also deter further investment in a neighborhood by current owners. The amount of a home-improvement loan is usually limited by the owner's equity — property value in excess of debt. If the value of a home drops, there may be no equity left for a home-improvement loan.

### Lending on FHA, VA loans

If a black homebuyer gets the appraiser's stamp of approval, there's still the issue of what kind of loan to get. In a black neighborhood, it's rarely what is called a "conventional" loan. Instead, it's likely to be one guaranteed by the federal government through the FHA or Veterans Administration (VA).

In middle-income black neighborhoods of metro Atlanta, 52 percent of home loans were insured by FHA or VA, according to 1986 real estate records sampled by the Journal-Constitution. In white areas of comparable income, only 13 percent of loans were government-backed. Even in upper-income black areas, 31 percent were FHA or VA.

Few of those FHA or VA loans come from banks and savings and loans. Twelve of 17 banks and savings and loans in the newspaper's survey made no FHA or VA loans in 1986. Bank officials said that was usually because those loans carry lower interest rates and more paperwork.

For many buyers, FHA and VA loans are the best way to buy, because of the lower down payment (or none at all) and low interest rate.

However, FHA and VA loans can have disadvantages for the neighborhood. If an area has many FHA and VA loans, banks and savings and loans may not make conventional loans there.

That may be the case in metro Atlanta. Banks and savings and loans made 50 percent of the con-

ventional loans in white middle-class areas, but only 22 percent of the conventional loans in comparable black areas where FHA and VA loans predominate, according to the real estate records.

Conventional lenders said they believe FHA and VA neighborhoods have higher foreclosure rates, since lenders whose losses are covered by the government may be less likely to choose borrowers carefully.

As far back as 1974, Savings and Loan News, the industry newsletter, issued this warning:

"Since the entry of FHA into the inner-city finance business, these areas have taken on new appearances — mostly depressing. The chronology looks something like this: (1) abandonment; (2) board-up and padlock time; (3) the vandalize and burn period; (4) wait-to-wreck interval (playtime in the Rockies); and (5) demolition."

The author, appraisal expert Gregory Opelka, began his article with what he called the "chicken or the egg caveat":

Are these neighborhoods deteriorating because lenders that make FHA and VA loans are there, or because the banks and savings and loans are not?

Opelka said it didn't matter.

"It is not my intention — nor should it be the appraiser's job function — to debate the morality of 'causes' and 'effects.'"

Whatever the cause and effect, homebuyers and homeowners in black neighborhoods can be trapped in an endless Catch-22:

■ Bank loan officers have become conditioned to steer clear of neighborhoods with a preponderance of FHA and VA loans.

■ Without a good mix of credit to fuel it, including conventional lenders, the housing market in the neighborhood sputters and property values stall.

■ Stagnant property values discourage investment and reinforce bank skepticism about the neighborhood, and the cycle begins again.

The Catch-22 has a second part:

Even if black borrowers can prove they deserve conventional financing, lenders will prefer to work in white neighborhoods, where higher sale prices and more sales mean higher commissions.

That's why Congress created the Community Reinvestment Act — to encourage banks and savings and loans to lend in all neighborhoods. The law has been on the books for 10 years.





# Selling lettuce, he built \$3 million firm, but can't get business loan

By Bill Dedman  
Staff Writer

Irvin Betts had only \$14 and an eighth-grade education, but he knew lettuce.

In 1981, he put \$4 worth of gas in his 1972 Gremlin, bought a case of shredded lettuce for \$10, drove to a restaurant and made a \$2 profit. Then he bought another case of lettuce and headed out again.

Seven years later, Irvin Betts is still delivering lettuce — 900 cases a week, as well as pomegranates and 277 other items. With seven trucks and 22 employees, Betts Produce in Forest Park sells \$3 million in produce a year.

Betts, who is black, built his business without a loan. Not that he didn't apply a couple of times, but he made do without.

That's often the only way a black person in Atlanta can build a business, according to local business experts.

Fred Stone, Georgia district director of the Small Business Administration (SBA): "Traditionally, blacks and other minorities have had a problem receiving financing from banks. I'll have to admit it's still a problem."

Sherman Golden, assistant director of the Fulton County Department of Planning and Economic Development, said, "Redlining is worse on the commercial side than in housing."

Charles Blackmon, a former bank officer who is director of the Atlanta Minority Business Development Center: "It's quite obvious that you have one set of lending rules for white males and another

set of rules for somebody else. We're not talking about an occasional case."

Raleigh Murphy, president of Renaissance Capital Corp., a minority small-business investment corporation: "The bank is making these loans to white establishments. You don't want to think it's out-and-out racism, but you wonder."

Marvin Arrington, president of the Atlanta City Council, said he asked banks six months ago to pool \$5 million for loans to businesses along Auburn Avenue, which in the early 1980s was the country's most vigorous black business area. "I got not one favorable response. Not one favorable response."

A federal law, the Community Reinvestment Act, says banks and savings and loan associations have "an affirmative obligation" to help meet the community's credit needs, including business loans, particularly those guaranteed by government agencies such as the Small Business Administration.

Many banks, however, make few or no SBA loans, according to a study conducted for The Atlanta Journal-Constitution. The newspaper used the federal Freedom of Information Act to obtain a computer printout of every SBA loan in Georgia from 1982 to mid-1987. The information was analyzed by the Southern Finance Project, an independent, non-profit research organization in Charlotte, N.C.

Those that do make SBA loans made few of them to minority- and women-owned businesses. Georgia has more than 100,000 minority- and women-owned businesses, according to the SBA. No institution loaned more than 20 percent of its

SBA dollars in Fulton, DeKalb, Cobb and Gwinnett counties to these borrowers. First Atlanta, which brought up the rear among the active SBA lenders, loaned 8 percent to these borrowers.

If each Atlanta area lender had loaned 20 percent of SBA dollars to minority and women borrowers, those borrowers would have received an additional \$21.4 million in credit over the five years.

The most active SBA lenders over the five years were Southern Federal Savings and Loan, with 264 loans in the four-county Atlanta metro area; Fulton Federal Savings and Loan, 175; Trust Company Bank, 148; Bank South, 139; Citizens and Southern Bank (C&S), 104; and NCB National Bank, 119.

The Southern Finance Project also looked at the location of SBA loans in relation to the location of deposits. The big three banks — C&S, First Atlanta and Trust Company — have a much smaller share of the SBA loans in black and low-income ZIP codes than their share



## Small-business lending

Atlanta's most active Small Business Administration lenders

Overall  
SBA loan  
performance

% of SBA dollars  
to minority- &  
women-owned firms

% of SBA dollars  
to minority  
and low-income  
ZIP code areas

| Rank             | Score | Rank             | Rank |
|------------------|-------|------------------|------|
| 1. Trust Co.     | 71    | 1. Trust Co.     | 20%  |
| 2. Southern Fed. | 66    | 2. C&S           | 14%  |
| 3. Fulton Fed.   | 64    | 3. Bank South    | 13%  |
| 4. Bank South    | 62    | 4. Southern Fed. | 11%  |
| 5. C&S           | 58    | 5. NCNB          | 9%   |
| 6. NCNB          | 48    | 6. Fulton Fed.   | 9%   |
| 7. First Atlanta | 35    | 7. First Atlanta | 8%   |

### How the rankings were determined:

The Atlanta Journal-Constitution used the federal Freedom of Information Act to obtain a computer printout from the Small Business Administration listing information about each SBA-assisted loan in Georgia from 1/1/82 to 5/30/87.

All analysis was done for the newspaper by the Southern Finance Project, an independent, non-profit research organization in Charlotte, N.C.

The overall ranking is based on a simple scoring system. Lenders were ranked in 43 categories measuring volume and distribution of SBA loans. The score shown in the table is the percentage of the total possible points. A score of 100 would mean that an institution finished first in every category.

Black ZIP codes are those that are more than 50 percent minority. Low-income ZIP code areas are those with more than 20 percent of residents below the federal poverty standard. Percentages are based on each institution's SBA loans in 303 ZIP codes.

Sources: Southern Finance Project; Small Business Administration; 1986 Sourcebook of Demographics and Buying Power for Every ZIP Code in the USA; Depository Institutions Performance Directory; Federal Deposit Insurance Corp.; Federal Home Loan Bank Board.

DAVE WINKS

of deposits in those areas. That's true even if the downtown ZIP code and bank headquarters are excluded.

But on an overall SBA rating, the Southern Finance Project judged Trust Company to be the leader. This rating combines overall SBA activity with the distribution of those loans to minority and women borrowers and the targeted ZIP codes.

"The only reason we're maintaining what we've had is because of institutions like Trust Company," said the business development center's Blackmon, who is black. "I still think we need some resensitizing to the needs of minority businesses."

Murphy's small-business investment corporation could help. It has raised \$1 million from the city's business community. All the big banks contributed, but Murphy, who is black, says some of them think that that donation disposes of their obligation to help minority businesses.

"We can't carry the whole

weight. They should be referring only the marginal deals, the ones that take a little more risk."

Part of the problem could be lack of business education, said Stone, who is white.

"You deal in perception, and the black entrepreneur often goes into the bank not understanding all the banker's terms or language, although his or her application may be just as worthy."

Banks also often don't want to make a small loan.

"Many of the banks have taken the position that they won't look at a request unless it's \$100,000," said Blackmon, who was a banker in Atlanta for 10 years. "That means the person has to have \$25,000 to \$50,000 in collateral. A lot of black people don't start with that kind of money."

Irvin Betts didn't. He said he

applied at Trust Company for a loan about 1985, then at Anchor Savings Bank last year. He said both told him he didn't have enough capital. He hopes to apply again for a loan soon so his business can grow. He sells to restaurants on credit terms, but, if he can't borrow money himself, his business can't increase as fast as possible.

"I could have maybe \$10 million or \$15 million in business if I had the working capital. If I had the money to work with I could buy most of my produce direct, cut out the middleman, increase my profit 15 percent."

Through the years Betts has seen other produce companies, white-owned ones, get loans and move ahead of him.

"I just keep trying. I don't let it get me down. Blacks always have a problem. Some just get lucky."

"I ask myself, how is it that so many neighborhoods are continuing to fail, while so many lending institutions are continuing to pass?"



— Sen. William Proxmire (D-Wis.), chairman of the Senate Banking, Housing and Urban Affairs Committee

5-3-88

May 3, 1988

## A test that few banks fail — in federal eyes

**Regulators say 98% obey lending law, but skeptics say communities shorted**

By Bill Dedman

Staff Writer

Each year the U.S. government grades America's 17,000 banks and savings and loans on how fairly they serve their communities, including working-class and minority neighborhoods.

Across the country last year, 98 percent of the lenders passed. In the South, 99 percent passed, according to federal agencies.

Supporters of working-class and minority neighborhoods suspect grade inflation.

"Regulators seem to think we all live in Lake Wobegon. Like the children of that fictional village, U.S. lenders are all above average," said Sen. William Proxmire (D-Wis.), chairman of the Senate Banking, Housing and Urban Affairs Committee.

Besides the annual exams, regulators are required by law to consider lending patterns when a bank applies for approval of a special action, such as opening a branch or buying another bank.

In the past 10 years, regulators have denied eight of 50,000 special applications because of unfair lending, according to federal agencies.

"I wish I had graders like that when I was in school," Proxmire said.



Proxmire said. "And I ask myself, how is it that so many neighborhoods are continuing to fail, while so many lending institutions are continuing to pass?"

Although applications are rarely denied, the law does allow for delays while regulators consider citizen challenges of a bank's record. A delayed merger can cost a bank a bundle in lost profits. Increasingly, community groups are filing such challenges.

Banks resent the pressure.

"They're a pain in the neck, and as far as we're concerned it's pure ol' blackmail, and I think we are going to see a lot more of it," Edward Crutchfield, chief executive officer of First Union Corp., said in a speech to a bank marketing convention shortly before First Union moved to Atlanta in 1986.

"They said we did not have

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# Law

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some specific things and they wanted \$50 million — boom. Well, we would have stayed awake until hell freezes over with that and we wouldn't have done it, and we didn't do it."

Other banks have done it. Banks have agreed to a variety of community demands:

- Specific goals for residential and home-improvement loans: \$150 million in Chicago, \$50 million in St. Louis, more than \$5 billion in all, since 1977, according to researchers at the University of Minnesota.

- In Iowa, a promise that a family with a broken furnace could get a \$2,000 loan approved in 24 hours.

- In St. Louis, low-cost checking accounts and cashing of government checks for non-depositors.

- In Philadelphia, loans to multifamily buildings.

And in many cities and states:

- Deposits of bank funds in community credit unions.

- Credit counseling services.

- Flexible underwriting criteria for loans to the poor.

- Loans with lower interest rates or lower closing costs or lower down payments.

- Charitable contributions to groups working in working-class and minority neighborhoods.

- Automatic second appraisals if appraisals are disputed.

Community groups say these results have not come from blackmail, just good ol' American pressure. They do, however, use the phrase "pull off" for a successful bank challenge, the same phrase historically applied to a heist.

Instead of a gun they use the Community Reinvestment Act (CRA). Approved by Congress and signed by President Carter in 1977, the law doesn't require a bank to

"The regulators have been haphazard. There's a pattern of the regulators being very close to the industry they regulate, being very reluctant to vigorously slap the wrist of people who violate the law."

— Allen Fishbein  
Center for Community Change

take any specific action or lend to anybody in particular. It creates no pool of money. It vaguely says banks have "an affirmative obligation" to serve all of their communities, including lower-income neighborhoods.

The law was intended to stop redlining, the illegal practice of avoiding areas in making loans because of race or other characteristics.

Ten years later, community groups around the country say redlining persists. Academic studies in Baltimore, Chicago, Denver and Washington, D.C., have found that banks rarely lend in working-class and minority neighborhoods. In Atlanta, even more than in these other cities, lending patterns follow racial lines, according to a study by The Atlanta Journal-Constitution.

The law has had beneficial effects, community groups say. But they say their victories came despite federal enforcement, not because of it.

"The regulators have been haphazard," said Allen Fishbein, general counsel for the Center for Community Change, a neighborhood advocacy group in Washington, D.C. "There's a pattern of the regulators being very close to the industry they regulate, being very reluctant to vigorously slap the wrist of people who violate the law. In many instances the regulators are defending the institutions more adequately than the lenders are defending themselves."

## Safety of deposits comes first

"We're not consumer activists —

we're regulators," said Ronald Zimmerman, vice president of the Federal Reserve Bank of Atlanta. "It's a terribly subjective law to enforce."

Still, leaders of the national regulatory agencies agree they could do better. They say they have had their hands full with their primary duty, ensuring the safety of deposits in banks and savings and loans. The increasing number of bank failures in this decade has stretched their resources.

According to BankWatch, the Ralph Nader gadfly of the nation's banks, the number of examiner hours per year expended to check banks on compliance with consumer regulations fell by 74 percent from 1981 to 1984 at the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corp., and the Federal Home Loan Bank Board, which regulate most of the banks and savings and loans. The Federal Reserve Board regulates only about 1,000 institutions.

"Our bank consumer compliance effort has not been as comprehensive as it should be," said William Seidman, chairman of the Federal Deposit Insurance Corp.

"As you are aware, in the early 1980s the thrift industry suffered a crisis," said Danny Wall, chairman of the Federal Home Loan Bank Board, which regulates savings and loans. "I regret to report that, as a result of this situation, we did not allocate sufficient resources to the enforcement of the CRA, or, for that matter, other consumer-related issues. The bank board has recently increased its activity in the area of





SCOTT ROBINSON/Staff

'We're not consumer activists — we're regulators,' says Ronald Zimmerman (right), vice president of the Federal Reserve Bank of Atlanta;

with him are Federal Reserve examiner Robert Kennedy (left) and examining officer William Estes III.

CRA after a long lull. There is still much work to be done."

While the annual examinations have decreased, challenges from community groups have increased. For example, the Federal Reserve received three protests in 1984, 19 in 1985, 20 in 1986 and 35 last year. One reason is that more banks are merging or expanding into other states, creating more legal opportunities for challenges. Another reason is that federal housing aid has

declined, causing community groups to seek more investment by banks in their neighborhoods.

Bankers who haven't been challenged should get their records in order before community groups start a protest. Glenn Loney, assistant director and community affairs officer of the Federal Reserve, told bankers in Philadelphia last year, according to *American Banker*, the industry newspaper.

"By the time they get to you in

three years, they are really going to be good."

#### 'Process somewhat abused'

In Atlanta last year, a new community coalition challenged SunTrust Banks, the parent of Trust Company Bank. Trust Company was able to complete the merger without making any specific financial

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## Law

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concessions, but it left the yearlong negotiations bitter.

"The process has been somewhat abused," said Jim Graham, a SunTrust vice president in charge of compliance with the CRA. "The law is probably a good law but unnecessary. The banks have been meeting their community needs for some years."

That may be true of many banks, activists agree, but they say the law doesn't allow them to know which less-responsible institutions

Activists say the law doesn't allow them to know which less-responsible institutions to challenge. The government keeps the grade for each bank a secret; not even the bank is supposed to know. Only regional and national totals are made public. The only information the public has is the federal reports of home loans.

to challenge. The government keeps the grade for each bank a secret; not even the bank is supposed to know. Only regional and national totals are made public. The only information the public has is the federal reports of home loans, the same information that formed the basis for the Journal-Constitution study of lending patterns.

"It's the traditional style of the regulators to be low-key and behind the scenes, but that stuff should be public," Fishbein said. "It's not going to damage a bank. The public should know that, so they know where they put their money. It might even gain the good lenders some business. If it's secret, a lender can claim to have a good record when it doesn't."

Regulators say releasing the grades would set a precedent for disclosure of more sensitive examination information. They say the grades would be misinterpreted: Banks shouldn't be compared with each other, but with their legal responsibilities. And when a bank does poorly, regulators say, they don't have to give bad grades or turn down applications to enforce the law.

"Denials are a last resort," said Comptroller Robert Clarke, whose federal agency regulates more banks than any other.

"Instead of kicking you out of school because you flunked the course, we give you tutorials so you can stay in school," Martha Seger, a governor of the Federal Reserve, told the Senate Banking Committee last month.

The regional grades show that nine banks out of 792 in 10 Southern states received grades of "less than satisfactory" in 1986, the most recent data available. None was judged to be "unsatisfactory" or "substantially inadequate." Out of 318 savings and loans, four were graded as "needs improvement" and none was "unsatisfactory."

Activists scoff at the higher grades for Southern lenders.

"In the South and Southwest, particularly, you've had banks getting away with murder for years — racial discrimination, redlining and dealing almost exclusively in commercial loans," said New Orleans neighborhood activist Michael Shea, national director of housing and banking campaigns for ACORN, the Association of Communities Organized for Reform Now. "I think the Atlanta Fed [Federal Reserve Bank] is shielding the banks from the public."

Regulators say evidence of disproportionate lending patterns is not enough to cause a bank to be penalized.

"It's not our job to allocate the credit geographically. We don't have hard and fast lines on that," Governor Seger of the Federal Re-

serve testified.

### Proposed changes in the law

This contentious triumvirate of bankers, community groups and regulators is lobbying now as Congress considers several proposals to improve enforcement of the CRA.

The lobbying battle is tied to expectations that Congress this session will probably change the rules on what business a bank can do. A bill approved by the Senate would permit bank holding companies to underwrite and sell mortgage-backed securities, commercial paper, municipal revenue bonds, corporate bonds, mutual funds, and perhaps eventually corporate stock, the most lucrative securities activity. A similar bill is pending in the House.

Viewing some form of expanded bank powers as apparently inevitable, community groups hope to slip in increased regulation through expansion of the CRA at the same time. Several bills to expand the law have been introduced in the House. Their provisions include these:

- Change the grading system so only exemplary banks receive a top grade.

- Disclose each bank's grade, as well as its CRA examination report.

- Allow banks with a top grade to expand their powers or expand into other states. Banks with average grades could expand only if they made specific commitments to improve community reinvestment.

- Create separate community affairs divisions in the four regulatory agencies to conduct the examinations separately from examinations for safety and soundness of banks.

- Require banks to disclose their commercial loans by census tract, as they now must disclose home-purchase and home-improvement loans.

- Require banks to provide low-cost "lifeline" checking accounts and to cash government checks for non-depositors with proper identification.

■ Establish a procedure for banks to notify the community and hear comments before they close bank branches.

Bank lobbyists have conceded that some of these changes are acceptable. The most disputed are the lifeline and check-cashing provisions, and some oppose the commercial loan disclosure.

Among the congressmen being lobbied is Rep. Pat Swindall, a Republican from metro Atlanta's 4th District. He is a member of the House Banking, Finance and Urban Affairs Committee, which is scheduled to consider the bills this month. His legislative assistant, Pete McLain, said Swindall has not taken a position on the bills.

"You've got to have some guidelines to protect these communities, but if you come in with too much regulation the banks will oppose it and you won't get a bill," McLain said.

Ranking higher on the House Banking Committee is another Georgian, Rep. Doug Barnard, a Democrat from Augusta who repre-

sents the 10th District. A banker by trade, he has been encouraging significant expansion of bank powers. He currently supports some provisions for increased consumer regulation, but not the lifeline and check-cashing provisions or commercial loan disclosure.

All sides suggest that this year is something of a last stand, because the law's most vocal and influential advocate in Congress, Proxmire, is retiring at age 72. He introduced the Community Reinvestment Act in 1977 to combat redlining and help revitalize inner cities.

"CRA was written, as I said 10 years ago, because there is no way the federal government can solve that problem with its resources," Proxmire said. "The private sector has the capital, the know-how and the efficiency to do the job. But the record shows that we have to nudge them, influence them, persuade them to invest in their own community."

WEDNESDAY: Reinvesting in Atlanta.

# Despite 'good citizen' image, Trust Company finds itself in a battle

By Bill Dedman  
Staff Writer

Trust Company Bank is an Atlanta institution.

The bank is proud of its historic role in promoting the city's economic health. Known as the "Coca-Cola Bank," Trust Company was led by the late Robert W. Woodruff, the Coke magnate remembered as the city's greatest philanthropist.

And the bank is proud of its historic role in promoting racial harmony. The late John A. Sibley, then retired chairman of Trust Company, was credited with holding Georgia's black and white leadership together in 1960-61 as public schools began desegregation, and he provided seed money for single-family housing for blacks in southwest Atlanta during tense times in 1962.

"Trust Company Bank has contributed to the shaping of Atlanta like few other institutions," the bank's literature says.

That's all true, say the leaders of an Atlanta neighborhood coalition. The Atlanta Community Reinvestment Alliance also says Trust Company doesn't lend much money to black people.

"I'm not going to try to tell you the bank's motives," said Dennis Goldstein, the Atlanta Legal Aid Society lawyer representing members of the coalition. "But the bank's policies have a racially discriminatory effect in the extreme."

The coalition filed a complaint with federal regulators last year against Trust Company's parent, SunTrust Banks. After negotiating unsuccessfully with the bank for a year, the group asked the Federal Reserve Board to stop a SunTrust merger. The group claimed Trust Company was redlining — not lending in working-class and minority neighborhoods — in violation of the federal Community Reinvestment Act.

SunTrust won, as has every other bank challenged through complaints to the Federal Reserve Board.

Trust Company says the coalition picked the wrong target.

"I think we get a bad rap," said Jim Mynatt, first vice president of Trust Company. "We don't have a map up there with a redlined district."

Trust Company ranked 15th out of 17 banks and savings and loans in the city in The Atlanta Journal-Constitution study of how much residential lending went to minority and lower-income neighborhoods. It did much better, ranking at the top, in an analysis of lending to minority businesses.

Coalition leaders say they chose Trust Company partly because of its lending records, partly because its merger plans provided a convenient target, and partly to make a point.

"Trust Company was not the worst bank," said Lynn Brazen, co-chairwoman of the coalition. "We studied five banks and two savings and loans. They were all bad. Some were worse than others. More

speakers at our neighborhood meeting complained about Trust Company more than any other bank.

"We also wanted to start with a community leader, a bank with an image as a good citizen," Mrs. Brazen said. "We weren't trying to tear down that image, but to let the bank be the leader in this, too. Let the bank take the initiative to improve its record."

Trust Company is the city's most profitable bank. It's also the one with the second-highest share of non-white customers, according to the 1986 Scarborough Atlanta Market Study for the Journal-Constitution. Trust Company drew 28 percent of the metro area's non-white customers, second only to First Atlanta's 31 percent.

Although Trust Company officials say they are fair and obey the law, they also agree that the common man is not their target audience.

The "vision statement" of parent SunTrust Banks includes this: "Our primary target markets are successful, growing businesses and institutions and individuals with above-average financial service needs."

Another bank publication adds: "Even though it is a large bank, Trust Company Bank still has limited resources. Management has decided that the way to have the most profound impact on the community is to deal largely with the corporate and wholesale markets."

"To say that the bank's emphasis is on corporate and wholesale



## The 12 factors in a CRA examination

Federal regulators are required to consider these factors in grading banks and savings and loans on compliance with the Community Reinvestment Act (CRA):

- Efforts to determine the credit needs of the community.
- Efforts to make the community aware of credit services.
- Board participation in setting CRA policy.
- Practices intended to discourage applications for credit.
- Geographic distribution of credit extensions, applications and denials.
- Evidence of discriminatory or illegal credit practices.
- Opening and closing of offices and providing services at offices.
- Participation in local community development projects.
- Making loans for home purchase, home improvement, small businesses or small farms.
- Participation in government loan programs for housing, small businesses or small farms.
- Ability to meet community credit needs.
- Other relevant factors.

banking decisions imply that the bank's leadership does not have a strong sense of community responsibility."

That's exactly what the community coalition implied.

The challengers focused on Trust Company's lending pattern, its closing of branches serving minority and lower-income neighborhoods, its refusal to offer fixed-rate mortgages and its lack of advertising in minority publications.

The coalition also said Trust

Company was the only major bank in town without a low-cost checking account, sometimes known as a life-line. For customers without a balance of \$500, a Trust Company checking account costs \$3 a month plus 30 cents a check.

The coalition waited a year to file its challenge, perhaps passing up its best opportunity. The coalition almost challenged a larger merger in 1986 that brought Tennessee's Third National Bank Corp. into SunTrust, but it backed off as

negotiations improved.

"We took them at their word on the basis of their promise to listen to our concerns in good faith," Goldstein said. "That might have been a mistake."

Members of the coalition include the Capitol View Manor Community Group and the Capitol View Neighborhood Association, as well as four groups that encourage housing for low-income neighborhoods: the Georgia Housing Coalition, Interfaith, South Atlanta Land Trust and Southeastern Reinvestment Ventures.

The challenge was joined by the city's Neighborhood Planning Unit M, which includes the Bedford-Pine, Sweet Auburn and Techwood neighborhoods; the Historic District Development Corp., which is developing housing in the Martin Luther King Jr. Historic District; the Sweet Auburn Merchants Association; and several area residents.

The negotiations, from September 1986 until the complaint was filed in October 1987, were often contentious.

The bank said its lending patterns were caused mostly because it offers no fixed-rate mortgages, which it said are preferred by residents of slower-growing, less transient areas. It offers only adjustable-rate mortgages, which appeal more to residents who will sell in only a few years.

"Thus, the fact that fewer mortgage loans were made by Trust Company Bank in black neighborhoods than in white neighborhoods is the result of the differing mobility and growth patterns between the white and black neighborhoods, rather than to racial discrimination," Georgetown Dickinson, assistant corporate counsel for SunTrust, wrote to the Federal Reserve.

As for a lifeline checking account, the bank said few people wanted such an account, it would lose \$25 a year on each account with a \$2.50 monthly fee, and it would not consider offering a lifeline account that lost money.

After negotiations started, Trust Company did advertise in the city's largest black newspaper, The Atlanta Daily World, in October 1986. It did not advertise again until October 1987, when it filed the merger application, but since then has been the newspaper's largest bank advertiser, according to advertising director W.A. Scott III.

At the same time, Trust Company began to make loans to a leading coalition member, the South Atlanta Land Trust.

"Trust Company has funneled half a million dollars my way since the negotiations began," said the land trust's founder, the Rev. Craig Taylor. "They've co-opted me to absolve themselves of their larger responsibility."

"I just can't believe Craig said that," said Trust Company's Mynatt. "Trust Company Bank has entertained any loan request that's come to us. The bank is very receptive to any of these housing projects."

At one point Trust Company questioned methods of the coalition's legal counsel, the Atlanta Legal Aid Society, of which the late John Sibley of Trust Company was a founder.

Last April, Trust Company's corporate counsel, J. David Webb, wrote to the executive director of Atlanta Legal Aid, Steve Gottlieb, asking if Legal Aid was soliciting clients to challenge SunTrust. If the lawyers were soliciting clients, Webb said, Trust Company would be unable to give its annual \$100-per-attorney donation to Legal Aid. After Legal Aid gave assurances

that the clients had come forward on their own, Trust Company made its usual donation.

Trust Company's arguments and information persuaded the federal regulators.

After one negotiating session, the chief regulator on the case, William Estes III, examining officer for the Federal Reserve Bank of Atlanta, wondered aloud why the group bothered to file a challenge.

"He said he was impressed by the communication between the bank and the community group," said lawyer Goldstein. "This was shocking to us, because the focus of the meeting was our complaint about the bank's lack of communication."

The coalition asked the Atlanta Fed to hold a public hearing. The request was denied.

In the end, the Federal Reserve Board in Washington refused to hear the challenge.

The coalition was not surprised, but it was angered that the regulator made a point of praising Trust Company.

"The record in this case," the Federal Reserve secretary wrote, "reflects that Trust Company has made efforts to serve the low- and moderate-income and minority communities in Atlanta through its House Money program and through its participation in a loan consortium that will provide below-market rate financing of single-family homes."

House Money, through which Trust Company offers home-purchase loans at half a percentage point below market interest rates in targeted neighborhoods, made nine loans from 1985 to 1987.

And the loan consortium hasn't made any loans yet.

"We took them [Trust Company] at their word on the basis of their promise to listen to our concerns in good faith. That might have been a mistake."

— Dennis Goldstein  
Attorney for Atlanta Community Reinvestment Alliance

May 4, 1988

# Bank protesters in Atlanta make ready to flex muscle

By Bill Dedman  
Staff Writer

One summer day in 1986, more than 700 residents of minority and working-class neighborhoods across the country invaded the American Bankers Association headquarters in Washington. They chanted, "2-4-6-8, we know you discriminate!" Eight protesters stormed the executive offices and were arrested.

One fall day in 1987, a dozen residents of minority and working-class neighborhoods in Atlanta stood silently in front of Georgia Federal Bank on Marietta Street. They had intended to wrap a red ribbon around the bank and chant about how banks didn't make loans



in their neighborhoods — redlining them — but they didn't bring enough ribbon. They demanded a meeting with the bank president, who didn't come out, so they left.

Bank protesting in Atlanta hasn't quite come of age, but it is growing. Two national community coalitions, with years of experience protesting and negotiating with bankers, are training neighborhood

5-4-88  
groups here. A dozen protesters from Atlanta attended a training session last weekend in Washington, where they debated bank regulators and joined in protests at several government offices and the home of Samuel Pierce, secretary of housing and urban development.

Atlanta banks are bracing for the storm. Trust Company Bank spokesman Willis Johnson has distributed an article by one group's national organizer. Marked in yellow is a quote from Mao Tse-tung:

"Deception is not enough — the enemy's leaders must be confused; if possible, driven insane."

PROTESTERS Continued on Page 8A



## Protesters

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Johnson said, "You have to wonder about a man's politics when he quotes from the 'Little Red Book.'"

That has been the first response in other cities where community pressure has been applied. Bankers point out that activists talk of "pulling off" a bank challenge the way robbers talk about a heist.

However, when banks have yielded to demands for more loans, they sometimes have been surprised by the results.

Three Chicago banks have made more than \$85 million in loans under agreements with community groups, and reported not one default in four years.

"We have learned that it is possible for a bank to expand its community reinvestment activities safely and moderately profitably," said Richard Hartnack, senior vice president of First Chicago Corp.

In Cleveland, Ohio, "we learned some very important and admittedly surprising lessons," said John Kolesar, president of AmeriTrust Development Bank. "We learned that it was not necessary to dilute the bank's credit standards in order to approve these loans. And we discovered that the market for credit in these areas was much greater than we had anticipated."

As demonstrated by The Atlanta Journal-Constitution study of lending, banks and savings and loans rarely lend money in Atlanta's black and integrated neighborhoods.

While there is a federal law saying banks have an affirmative obligation to serve all of the community, federal regulators acknowledge that enforcement has been less than comprehensive.

So community groups depend on local pressure.

Their agenda in Atlanta:

- Request the banks to include all neighborhoods in their normal lending programs for home and business loans, and to change loan policies that they believe discriminate against minority, working-class and older inner-city neighborhoods.

- Ask the banks to set up special programs to help lower-income neighborhoods. The groups say a \$10 million pool, debated for six months by Atlanta's largest banks,

would be a start. They suggest \$100 million a year.

- Invite the banks, insurance companies, foundations and local governments to support housing efforts and help spawn others, such as a development corporation planned by Fulton County.

- Appeal to Atlanta city officials to keep city deposits out of banks with poor lending records.

- If all else fails, picket to encourage depositors to pull money out of banks.

Most neighborhood leaders say they are not accusing bankers of being racist.

"None of these people I've met are racist," said the Rev. Craig Taylor, a Southside non-profit housing developer and a director of the Atlanta Community Reinvestment Alliance, one of the two local organizations challenging banks. "None of them is your stereotypical hard-hearted banker. I have never met a group of people with more honesty and integrity and good hearts than bankers in Atlanta."

"But, institutionally, the banks have been across-the-board clearly unresponsive to the city's major problems, they have tended to define those problems in their own self-interest, and they have tended to give nothing more than paternalistic appeasement to keep poor people and minorities in their place, to keep them corralled and isolated and controlled."

### 'Bank-ins' around the city

The first steps on the route from redlining to reinvestment were taken in 1970 on the northwest side of Chicago, when an angry Italian walked into the office of a Methodist minister.

"He said his son went down to the bank and couldn't get a loan 'cause of where he lived," said Shel Trapp, the minister. "So we went over to see the bank and they said, 'Of course we don't make loans in that neighborhood. It's a slum.' They weren't as careful about what they said back then."

Trapp, the baldheaded minister who quoted Mao, looks and acts more like a middle linebacker for the Bears. He huddled the members of his neighborhood group and rushed to the bank for a "bank-in."

They opened up their penny banks, took the pennies down to the



## Where to report discrimination

- National Bank. ("National" or "N.A." appears in the bank's name.) Contact the Office of the Comptroller of the Currency, 404-331-4540 or 202-447-1800.
- State-chartered bank in the Federal Reserve System and FDIC-insured. (Sign at the bank will say "Member, Federal Reserve System" and "Deposits Insured by Federal Deposit Insurance Corporation." "National" and "N.A." do not appear in the name.) Contact the Federal Reserve Board, 404-521-8500 or 202-452-3000.
- State-chartered banks and savings banks not in the Federal Reserve but FDIC-insured. (Sign will say "Deposits Insured by Federal Deposit Insurance Corporation." No sign will say "Member, Federal Reserve System." "National" and "N.A." do not appear in the name.) Contact the FDIC, 404-525-0308 or 800-424-5488, or the Georgia commissioner of banking and finance, 404-393-7330.
- Federal Savings and Loan Associations and Federal Savings Banks. (Generally, "Federal" or "FSB" or "FA" appears in the name. Sign will say "Deposits Insured by FSLIC" or "Deposits Insured by FDIC." Contact the Federal Home Loan Bank Board, 404-888-8000 or 202-377-6237.
- Federally chartered credit unions. ("Federal credit union" will appear in the name.) Contact the National Credit Union Administration, 202-357-1065.
- Finance companies and other lenders not listed above. Contact the Federal Trade Commission, 202-326-2222.

bank, and changed them into dollar bills. Then they changed them back to pennies. Then they changed them into dollar bills....

"We tied up the lobby half the day," Trapp remembers. "That afternoon we got a meeting with the board of directors of the bank. They agreed to make \$4 million in mortgage loans in our neighborhoods, \$4 million in home-improvement loans, and they gave \$1,000 to our group. We thought that was the end of it, but other groups called us and we started bank-ins around the city."

On the West Side of Chicago another juggernaut was gaining power. It took the form of Gale Cincotta, a housewife and mother of six. She became a community organizer in the 1960s as a PTA mother upset that her children's West Side schools didn't get their share of city money. Then she found that Chicago's banks were accepting deposits from her neighborhood, but not making loans there.

"When we said, 'Why aren't you in our neighborhood?' we were really paying the banks and savings and loans a compliment. We want

them in our neighborhoods. They didn't take it as a compliment," Mrs. Cincotta said.

Trapp and Mrs. Cincotta combined forces.

They stood in front of the banks in Chicago's Loop using a megaphone to lead residents in chants. They tried to dock a houseboat at the city's convention center during the American Bankers Association convention. They led a parade of school buses full of residents to the suburban Chicago homes of bank presidents, including the president of the association.

"Gale and the banker were out front shouting at each other while the neighborhood women were taking their kids around to the back door asking to use the bathroom, and the banker's wife was letting them in. So here they go tramping through the house," Trapp said.

### Congress gets in the act

By 1975 neighborhood groups had won congressional approval of the Home Mortgage Disclosure Act,

which required banks to tell where they made home loans.

But releasing the numbers didn't end redlining, community groups said, so they went back to Congress. In 1977 they won approval of the Community Reinvestment Act, which for the first time said banks and savings and loans have "an affirmative obligation" to serve all segments of their communities.

Use of the law by community groups, particularly to stall bank mergers, has led to lending agreements in many cities.

"You're starting to see communities come back to life on the West Side of Chicago," Mrs. Cincotta said. "The decline has stopped. The neighborhood has hope. The banks are starting to see it as a good place to do business. Properties are going back on the tax rolls. The city is putting in sidewalks and curbs. It has this kind of snowball effect."

Through the years protesters and bankers around the country have built up some understanding, possibly even some mutual respect. The community groups have worked with bankers to implement lending agreements; they hold training sessions for regulators. They even invited bankers to their national training session last fall on "how to beat the banks."

"Banks are never going to admit they redline," said Tom Schraw, a Cincotta-Trapp disciple at their National Training and Information Center in Chicago. "What happens eventually is that we get past that debate and move toward agreement on an action-oriented program. You can look back a year or two later and the numbers [of loans] have gone up. Whether that's because they're doing something new, or because they stopped doing something they were doing doesn't matter. What matters is that the numbers go up."

### Showing off the neighborhood

One of the most effective techniques, community organizers said, is to rent a bus.

"What we've found is the best thing," Mrs. Cincotta said, "is to drive them, the bankers, around the neighborhoods so they can see that there are good houses. We do not want them to make bad loans. You build that trust one step at a time."

"The culture that bankers live in is so different from the culture

that low-income and minority people live in," said Jane Uebelhoefer, Washington legislative director of ACORN (Association of Communities Organized for Reform Now). "That gap has to be bridged."

Now ACORN and the Chicago organization, the National Training and Information Center, are working in Atlanta.

Elena Hanggi, the former national president of ACORN, has been to Atlanta several times this spring to help its local chapter organize residents against the banks.

From the National Training and Information Center, Trapp has been advising the Atlanta Community Reinvestment Alliance (ACRA), which is seeking increased lending by banks in Atlanta. The alliance filed an unsuccessful protest with federal regulators last fall against SunTrust Banks, parent of Trust Company, and negotiated several changes in loan programs and depositor services at Georgia Federal.

After meeting with ACRA, Georgia Federal agreed to provide home-purchase loans at lower interest rates in inner-city areas, financial counseling for potential homebuyers at inner-city branches, and low-cost money orders at three southwest Atlanta branches.

When ACORN showed up at Georgia Federal, the bank refused to meet, saying it was already negotiating with ACRA.

The groups have different approaches. ACRA criticizes ACORN for the paltry protest at Georgia Federal; ACORN claims ACRA members are too eager to accept a few loans.

And they have different constituencies. ACRA claims ACORN has too little business savvy to command respect from the banks; ACORN claims ACRA is just a bunch of white liberals with no community base.

Still, they agree that minority and lower-income neighborhoods need to be organized.

"My agenda is to build power in these communities," Trapp said. "Kicking ass is power."

Bankers are getting ready.

But in the pamphlet where Trust Company's Johnson marked the quote from Chairman Mao, he missed a line. Trapp espouses the "fun" of having poor residents go to a banker's house and have a redlining party by throwing red crepe paper in the yard.

# 'Anybody can sit out there and mouth off — he gets things done'

By Bill Dedman  
Staff Writer

As a nuclear missile launch officer in the 1970s, Lt. Craig Taylor had the power to destroy cities. He was uneasy.

"We almost launched some nukes, and I got religious."

As a Methodist minister and housing developer in the 1980s, the Rev. Craig Taylor is gaining the power to build a city. He is uneasy.

His unease comes from his conflicting roles.

As a leader of a neighborhood coalition, the Atlanta Community Reinvestment Alliance, Taylor is the city's most outspoken critic of banks for not lending in minority and working-class areas.

As a leader of the South Atlanta Land Trust, a non-profit housing developer, Taylor is the first person banks lend to in those areas.

"Four banks have been giving me the red carpet the past two months: Trust Company, First Atlanta, Georgia Federal and C&S," said Taylor. "The banks probably think I'm ungrateful, and the other folks [activists] probably think I'm selling out. I'm castrated as a negotiator for the neighborhood."

In fact, bank officials and housing activists — who don't seem to agree on many things — agree that Taylor is the best example of the potential of Atlanta's inner-city Southside.

"I wish we had a hundred more like him," said Jim Mynatt, first vice president of Trust Company Bank, which Taylor's coalition unsuccessfully accused last fall of redlining. "Anybody can sit out there and mouth off — he gets things done."

The back door of Taylor's office on Jonesboro Road has three peepholes and a slot — so former tenants could watch for cops and receive drug deliveries, he said.

A 36-year-old Louisianian with a hint of Cajun accent, Taylor came to the South Atlanta neighborhood four years ago through Wesley Community Centers.

He found a sliver of the Southside, with 42 of its 500 houses vacant and dilapidated. (The South Atlanta neighborhood is bounded by Carver Homes on the west, Jonesboro Road on the east, McDonough Boulevard on the north and Turman Avenue on the south.)

Junk piles flourished. Speculators had bought up much of the neighborhood, waiting for Southside development that was always "just five years away."

"If you can do housing in this neighborhood, you can do housing anywhere," Taylor said.

He did not expect government to solve the neighborhood's problems.

"I see my approach as somewhat akin to Mr. Reagan's. I think government's role ought to be enabling local communities to meet their local needs, as opposed to having governments do it themselves."

When he arrived in 1984, residents already had formed the South Atlanta Land Trust (SALT), which he joined as full-time consultant.

SALT started small — clearing a junk-piled vacant lot — then began buying land to protect neighborhood boundaries from speculators.

In 1985, SALT started renovating houses. It moved in 13 others

from the airport noise zone.

Residents also began to push the city to enforce laws against trash piles and unsafe buildings, and to police an area that residents called "Cocaine Alley."

And they looked to the banks.

"We tried to get long-term financing for our people from several banks and didn't get the time of day," Taylor said.

"So we became bankers — not out of choice but out of necessity."

Taylor persuaded banks to begin lending money to SALT, which then loaned to homebuyers. Residents buy only the house; SALT keeps the land to prevent residents from selling to speculators.

The preacher-developer-banker once received a pinstriped suit as a gift, but he still usually wears jeans. And he chooses borrowers somewhat differently than banks do.

"I ask them a question and look directly in their eyes and see if they're telling the truth. If they're honest, I'll sell them a house."

Not one of his more than 30 borrowers has defaulted, Taylor said.

Taylor calls bank lending rules "arbitrary and impersonal." For example, under standard banking rules, a borrower can have no more than 28 percent of gross income committed to housing debt.

"If they're able to pay 60 percent for garbage rental housing, they can pay 40 percent for homeownership," Taylor said. "It's that kind of cultural understanding that the bankers downtown lack."

Banks also will usually lend no more than 80 percent of the value of a home without requiring private mortgage insurance, which homebuyers and lenders report is diffi-

cult to obtain in some inner-city neighborhoods.

Taylor suggests that lenders should look at it from a different perspective:

If a two-income suburban husband and wife have an income of \$100,000 and make a 10 percent down payment on a \$100,000 house, or \$10,000, they have invested one-tenth of a year's pay.

If a \$20,000-a-year city sanitation worker and his wife, a homemaker, put down 10 percent on a \$40,000 house, or \$4,000, they have invested one-fifth of a year's pay.

"Which family has a greater

stake in its house? Which family is less likely to walk away from that loan?" he asks. "We make 99 percent loans and families don't walk."

Karen Pleas heads one of those families. The 32-year-old is raising four children — two of hers and two of her late sister's — in a SALT house. Ms. Pleas works at a bank, Citizens and Southern (C&S), but knew she didn't qualify for a loan because of an unpaid student loan.

"We bought one of the riffraff houses," she said. "People were scared and just shut off their lives. Now my neighbors are painting their houses. There's a gorgeous

blue around the corner."

SALT is ready to begin work on its 37th home, and soon will finish its eighth apartment. Taylor's goal is to renovate 125 houses, one-fourth of the neighborhood.

"By the time we reach that level, it should have turned a corner. That's a theory," Taylor said.

When that happens, Taylor hopes the banks will be ready to meet the credit needs of individual residents. And, as SALT sponsors other land trusts on the Southside, he hopes those trusts won't have to wait the years he waited to build credibility with banks.

# Months of work, but lending pool still bone-dry

By Bill Dedman  
Staff Writer

Imagine a mortgage rate of 6.8 percent in Atlanta.

That's the rate that could be offered to about 250 working-class homebuyers in the city from a \$10 million lending pool formed by Atlanta's largest banks.

Maybe.

Although the pool was proposed by a neighborhood coalition 18 months ago, although plans were drawn up by bankers a year ago, and although negotiations among banks began six months ago, the pool today is dry.

"You've got to know how difficult it is to bring seven or eight lenders together and agree," said Jim Mynatt, a first vice president of Trust Company Bank, which is leading the pool effort. "We have commitments from everybody, but we're working on the details."

The effort suffered a blow in February when Citizens and Southern Bank (C&S), the state's largest bank, pulled out. C&S had been expected to make the largest contribution, more than \$2 million. C&S said it could help neighborhoods more through its own efforts.

Pool leaders declined to discuss many details. However, a copy of "working drafts" was obtained by The Atlanta Journal-

Constitution, and several participants discussed negotiations.

Trust Company called the pool meetings last fall after a community alliance filed a red-lining claim against the bank's parent, SunTrust Banks. Regulators with the Federal Reserve Board cited the effort to set up the pool as one of their reasons for dismissing the complaint filed by the Atlanta Community Reinvestment Alliance (ACRA).

"The mortgage consortium, I guess, is a response to ACRA's desires," Mynatt said.

At the same time, Trust Company's Willis Johnson suggested that the need for such a pool may have been overstated.

"We hope it will meet some of the needs that have been raised — even if they aren't that awesome," he said.

This pool would be small compared with those in some other cities — three Chicago banks committed \$150 million for special home loans. And it keeps getting smaller.

■ As proposed in 1986 by the alliance, the pool would have included \$10 million a year each from 10 banks for single-family homes, a total of \$100 million. That would fund 2,500 loans at \$40,000 apiece.

■ As modified in March 1987 by Trust Company, the pool would include \$5 million a year from 10 banks, a total of \$50 million or about 1,250 loans.

■ As now being discussed, the pool would include eight banks and a total of \$10 million, or about 250 loans.

■ The original Trust Company proposal also identified multifamily housing as a great need in the city, and included an additional \$5 million a year per bank for loans to non-profit developers of multifamily buildings. However, no multifamily housing is now included.

"We'll learn to walk before we can run," Mynatt said.

■ The original plan also allowed for "creative" underwriting and appraisal, allowing more homebuyers to qualify. This proposal has been hotly debated.

"Unfortunately, my feeling is it isn't going to work unless you lessen the underwriting criteria," said Frank Burke, chairman and chief executive officer of Bank South. "You won't have the applicants."

"There's no doubt you'll get applicants. The question is, will you get applicants who are qualified," said Thomas Boland, vice chairman of First Atlanta. "I wouldn't mind some with lesser underwriting criteria, but the worst thing we could do is to make a loan to a fellow and he not be able to repay it properly. He's lost his down payment and he's lost his dignity."

The original plan called for each bank to take turns handling pool paperwork. Trust Company volunteered to be the first lead bank, handling all paperwork until the job rotated to another. Borrowers would pay only one origination fee, which the referring bank and the lead bank would share.

However, a majority of the lenders preferred creation of a separate company to make the loans, Trust Company officials said. Legal questions about that possibility are being worked out with state officials.

"I can't tell you how fast this will happen," said Johnson, a



Trust Company spokesman. "We're not dragging our feet over here."

The largest setback so far was the pullout by C&S.

"We traditionally will do better if we're competing with somebody than if we're holding hands," said Bill VanLandingham, C&S president. "We're looking at some things that could be done. It's not as if we're not doing things now."

On Tuesday, C&S spokesman Dallas Lee said the bank plans to offer \$5 million in home-purchase loans, about 125 loans, at 1 percentage point below its normal interest rate. The loans would be available south of Interstate 20 inside the Perimeter. Lee said the program has been planned for months, but VanLandingham had not been in a position to announce it earlier.

The banks that were invited to a meeting on the pool last October by Trust Company were C&S, First Atlanta, Bank South, First Union, First American and Citizens Trust. Georgia Federal Bank was added later. Each bank would contribute according to size, as measured by deposits. Others have since agreed to make up the amount lost by the C&S pullout.

The low interest rate would

be achieved by a combination of bank and government effort. The banks would offer an interest rate half a percentage point below market rate. The Georgia Residential Finance Authority would push that lower by using a mortgage credit certificate, which provides a homebuyer a federal income tax credit of up to 20 percent of the annual mortgage interest, in addition to the normal interest deduction for homebuyers. Homebuyers could adjust their tax withholding at their place of employment to receive the tax credit up front.

So, if the market rate were 9.5 percent, the pool would offer loans at 9 percent. The tax credit would reduce the effective rate to about 6.8 percent.

"That's dynamite," said David Crum of the residential finance authority.

The proposal called for 30-year, fixed-rate loans to homebuyers with household income of \$33,000 or less. The proposal also said borrowers would have to have at least one month's payment set aside, a provision opposed by neighborhood groups. The proposal allowed loans of 87 percent of home value on loans up to \$35,000, and 90 percent on larger loans up to \$50,000.

The pool also would have an

effective income minimum.

"You're not going to find much [housing] under \$40,000 in the Atlanta market that can stand up to a 30-year mortgage," Crum said. "People can only afford a home valued at a little more than two times their annual income, so this program would be good for anyone who makes more than about \$18,000."

Some neighborhood advocates are critical of the pool.

"They're throwing us a bone," said Grant Williams, an Atlanta organizer for ACORN, the Association of Communities Organized for Reform Now.

Others welcome the idea.

"We are concerned that the amount of money is low and the commitment is questionable," Ms. Monter said. "But it is the first time they've done anything. I hope they put it together."

Crum, of the residential finance authority, said the bankers also are tired of the delays. Many bankers believe a pool could serve as shark-repellent against challenges such as the one against Trust Company.

"These are frustrated bankers," Crum said. "They've been backed and backed and backed into the corner. This is yet another attempt on their part to make an effort. It ought to be given a shot, not shot at."

# City Council calls meeting to review lending patterns

By Bill Dedman  
Staff Writer

The Atlanta City Council has called a special meeting today with members of Atlanta's financial institutions to discuss lending patterns described in The Atlanta Journal-Constitution series "The Color of Money."

The public meeting is scheduled to begin at noon at the Westin Peachtree Plaza Hotel in Tower Room 8 on the eighth floor. Chief executives of Atlanta banks and savings and loan associations have been invited.

The series of articles, which concludes today, describes how Atlanta banks and savings and loans rarely make home loans in black or integrated neighborhoods. The arti-

cles were based on a Journal-Constitution study of lenders' reports to the federal government.

"We're going to ask them if the numbers are correct. And, if they're correct, what are they going to do about it," said Marvin Arrington, president of the council. He said a biracial group of council members agreed Monday to call the meeting.

Council member Jabari Simama said, "We need to take serious, extraordinary steps to put pressure on the banks to do better."

Tuesday morning, Fulton County Commission Chairman Michael Lomax was interviewed on NBC's "The Today Show" in a report on the lending study. His problems securing a home-improvement loan



"We're going to ask them if the numbers are correct. And, if they're correct, what are they going to do about it."

— Marvin Arrington,  
Atlanta City Council  
president

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were described in a Sunday article in the series.

Lomax was asked how the lending statistics might affect Atlanta's national reputation, especially with the Democratic National Convention coming up in July.

"I'm not very concerned about the fact that we've had the problem (in the past)," Lomax said. "I'll be really judging our community on how we respond to it in the future. If the banks are defensive and angry, as some of the banks have been in response to the article, then I think we're not going to make any improvements."

"If they recognize with the help of the newspapers that there is a problem — that, whether they were motivated to discriminate or not, the effect of their policies has been discriminatory — if they change those policies and aggressively lend on a color-blind basis, I think we'll continue to be a pacesetter racially."

Also interviewed on the show was Henry B. Garmon, chairman and chief executive officer of Fulton Federal Savings and Loan. "To-

day" show producers said they called several Atlanta banks, but all declined the opportunity to have a representative on the program.

"Certainly it's troubling to think that these stats are true, and if they are, why they are true, and we would like to find out exactly what we're doing that could prevent this sort of thing if in fact it is true," Garmon said. "We began to look at it yesterday and actually had a meeting scheduled with management this morning to discuss some of our internal stats that might help shed some light on this."

Garmon said Fulton Federal, the second-largest savings institution in the state, does not consider race in its lending. He added that his institution and others need to determine if they do not have enough contact with real estate agents who could refer homebuyers from black areas.

Later Tuesday, Garmon's spokesman, Jim Wallace, said, "The issue was discussed at the meeting. No momentous steps were taken. No task forces were set up. Right now it's kind of a wait-and-see."

# City Hall clout could sweeten home-loan pot

## Municipal deposits a bargaining chip, activists contend

By Bill Dedman  
Staff Writer

In 1979, when most Atlanta banks excluded blacks and women from their boards of directors, Mayor Maynard Jackson threatened to move city money to banks in Birmingham or California. The Atlanta banks found seats in the board rooms for blacks and women.

In 1984, when some Atlanta banks loaned money to South Africa, the City Council made it illegal to put city money in banks that continued the loans. The banks stopped lending to South Africa.

Today, Atlanta banks rarely lend money to homebuyers in black and integrated neighborhoods, according to The Atlanta Journal-Constitution's lending study.

Activists protesting lending practices in Atlanta say it's time to use city deposits as a lever again.

"In the city we have a black political structure. Why not exercise some of that clout on the white business community, the banks, the foundations, the United Way?" asked the Rev. Craig Taylor, housing developer with the South Atlanta Land Trust and a director of the Atlanta Community Reinvestment Alliance.

Atlanta's political powers are not united on the question.

Only one leading politician, City Council President Marvin Arrington, spoke for more regulation.

"There's no question in my mind that I would approve an ordinance like this," Arrington said. "If it wouldn't pass, what did Martin Luther King Jr. live for?"

Mayor Andrew Young expressed more ambivalence.

He recalled that he had less trouble getting a mortgage from a savings and loan when he moved to Atlanta in 1961 than he had had in New York City.

"I would hate to think we've slipped," Young said. "It's the kind of thing you want to hope we've moved beyond. If there is serious redlining, it's not good for the city. It poisons the whole city."

At the same time, the mayor said he thought banks were not intentionally avoiding black areas, but might be fearful of risking money anywhere in the city. He said Atlanta bank financing has eluded even white developers of commercial property, such as John Portman.

After a real estate crash in the 1970s, "the banks lost a lot of their bullishness on Atlanta," Young said. "But they've made money hand over fist being conservative. The city's grown — almost despite them."

Young said he hoped that city regulation would not be necessary. He said the banks have responded well to his personal pleas for involvement, such as for Underground Atlanta and loans to help finance the Democratic National Convention.

The two men most likely to compete to be the next mayor also stressed negotiation first.

Fulton County Commission Chairman Michael Lomax has received contributions from banks for

his 1989 campaign for mayor but also said he was turned down by two banks for a home-improvement loan because he lived in the wrong neighborhood. Lomax opposes linking city deposits to bank lending.

"I've never encouraged that in Fulton County. My preference would be to raise the issue with the banks in a positive way," Lomax said. "It can be a win-win situation. Nobody has to lose for blacks to make their neighborhoods acceptable."

And Jackson, the city's first black mayor and expected to be a candidate again next year, hopes to raise campaign funds from the white business community, or at least to blunt its opposition. He said pulling money out of the banks is an option, but not the first option.

"I like to try to negotiate things first," Jackson said. "You're talking about conservative institutions. That's not going to change. There are probably banks that are going to be more responsive than others; we have to find those banks and work with them, organize their efforts. To whatever extent we can legally and economically leverage city money, I'm willing to consider that."

Some cities and states have used city deposits to increase lending.

"After you get done impugning each other's motives, and who should do more for whom, and how somebody's a rat and you're not, and you get past that level, ultimately you have to get down to what's practical," said George Stone, first deputy commissioner of Chicago's Department of Housing.

"Taking money out of a bank is

practical."

Governments have tried two approaches: the carrot and the stick.

The carrot: Put government deposits in banks to reward them, or set aside city funds as a loss reserve for loans to lower-income homebuyers and small businesses. Chicago, Iowa, Michigan, Missouri, Ohio and Wyoming have tried such measures.

The stick: Chicago, Washington, D.C., Hartford, Conn., Colorado, Illinois, Massachusetts and West Virginia place government funds only in banks that meet specific standards for lending.

To determine which banks should receive taxpayer deposits, other governments have required banks to disclose where they make business loans, where their depositors live and their lending rules.

Deposits are the raw material of banking, like iron to U.S. Steel. And Atlanta's five largest banks receive

more than a billion dollars in public deposits from local, state and federal governments — 6 cents of every dollar in the bank, according to bank annual reports.

Most of the money in Atlanta's \$290 million budget is funneled immediately to investments, mostly at banks. On an average day the city has about \$1.4 million in regular accounts, according to Pat Glisson, city commissioner of finance.

The city used to rotate its 12 larger checking accounts from year to year among what were the city's five largest banks. Beginning January 1987, the city pooled its funds in one account and sought bids from banks. The bank offering the highest return on the city's money got a two-year contract. That was First American Bank. The next bids will be taken this fall.

First American ranked last in the Journal-Constitution's study of lending to comparable white and

black middle-income neighborhoods.

Besides the general fund, the city keeps other accounts in the black-owned Citizens Trust Bank and in First Union Bank.

Citizens Trust, too small to compete for the general fund, receives the city's federal grant money.

First Union, previously First Georgia, handles the city's two pension funds. It was the first white-owned bank in Atlanta with a black director.

While the city isn't using its deposits as a lever, Jackson suggested that residents could.

"You've got to ask yourself, 'Do I want to continue doing business with that bank?' And the answer is no," Jackson told a recent meeting of the Association of Communities Organized for Reform Now (ACORN). "They're using your money to lend to somebody else."



## Public deposits

Where governments put public money

| Bank                     | \$ Public deposits | Share** | % of bank's total deposits |
|--------------------------|--------------------|---------|----------------------------|
| 1. C&S Bank              | \$593,600,000      | 52%     | 9%                         |
| 2. Bank South            | 202,132,000        | 18      | 10                         |
| 3. First Atlanta Bank    | 109,917,000        | 10      | 2                          |
| 4. First American Bank   | 81,630,000         | 7       | 7                          |
| 5. Trust Company Bank    | 74,180,000         | 6       | 2                          |
| 6. First Union Bank      | 61,707,000         | 5       | 3                          |
| 7. Citizens Trust Bank * | 22,578,000         | 2       | 29                         |
| 8. Other banks           | 845,000            | 0       | 4                          |

\* Black-owned institution  
\*\* Share of public deposits

Note: These figures represent federal, state, county and other government deposits.

In 1986, when these figures were gathered, the city of Atlanta rotated its largest account, the general fund, among the five largest banks in the city from year to year. It was deposited in Bank South when these figures were gathered. In 1987 the city began to seek bids for its account, and First American won the first two-year bid. Other city deposits are not bid. The city places federal grant money in the black-owned bank, Citizens Trust, and pension funds in First Union.

Source: Sheshunoff's Banks of Georgia, 1986.

# Panel appointed to probe banks' lending policies

5-5-88

May 5, 1988

Black leaders take series of actions  
in response to newspapers' articles

■ *Fulton approves fair housing ordinance. Page 1B.*

By Bill Dedman  
Staff Writer

Black leaders moved on several fronts Wednesday in response to disclosures of unequal lending patterns by Atlanta banks and savings and loans.

The actions came after a series of articles this week in *The Atlanta Journal-Constitution*. The series, "The Color of Money," described how Atlanta banks and savings and loans rarely lend money to home buyers and home owners in black or integrated neighborhoods.

Among the developments:

■ At a special meeting, the Atlanta City Council formed an "action committee" of politicians, bankers and citizens to investigate the lending practices of Atlanta financial institutions. Council President Marvin Arrington said the committee should "come back with some hard recommendations" in 20 days.

■ The Fulton County Commission unanimously approved a law prohibiting discrimination in the sale, rental or finance of housing. The fair housing ordinance had been held last week; several commissioners said the *Journal-Constitution* articles spurred the reversal.

■ Earl Shinhoster, the Southern regional director of the NAACP, said in an interview that black depositors should withdraw funds from white-owned banks "if lending policies and practices do not change substantially."

■ Bank executives said at the City Council meeting that they do not quarrel with the figures in the *Journal-Constitution* report but emphasized that they do not intention-



ANDY SHARP/Staff

ally discriminate.  
City Council President Marvin Arrington (standing) and Lee Sessions, C&S executive vice president, at special meeting on bank lending practices.

ally discriminate.

■ City Councilman Bill Campbell urged the city and other local governments to reconsider where they deposit taxpayer money.

■ Fulton County Commissioner Gordon Joyner said local govern-

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# Banks

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ments should consider asking the U.S. Justice Department to investigate lending practices in Atlanta.

■ Fulton Commission Chairman Michael Lomax called on banks to take "affirmative action" to improve lending records and to publicly apologize to the black community and the city.

■ City Councilman Victor Masalia, a white bank officer, said banks should release figures on applications by blacks and whites so the full story can be told. Just two of 88 institutions would divulge those figures to the Journal-Constitution.

■ State Sen. Arthur Langford, chairman of the Senate Consumer Affairs Committee, said in an interview that his committee would call hearings and seek "clear-cut, definite solutions" if banks and savings and loans did not change lending practices.

■ U.S. Rep. John Lewis said in an interview that he planned to call on members of congressional banking committees to strengthen the Community Reinvestment Act, which says banks have "an affirmative obligation" to lend to all parts of their communities.

The special City Council meeting had been scheduled as a quiet discussion over lunch. But the small meeting room at the Westin Peachtree Plaza Hotel was packed with more than 60 politicians, lenders, journalists and citizens.

"We're not here to beat up on anybody, but to find some solutions to some problems," Arrington said. "I want to hear from some of our banking friends and people at the savings and loans if we have a problem, if what we read in the paper was true, and how do we respond to it."

Several times when Arrington called for responses from bankers there were no volunteers. However, three bankers did suggest that lending disparities do exist.

"I think anytime that there's a

perception of a problem, that there must be a problem," said Lee Sessions, executive vice president of Citizens and Southern Bank. "I think obviously there's a perception of a problem, and we need to address it. I think there might be a wrong impression, though, that the financial community has been idle. In the past three years, we've tried to put out in the low-income census areas of Atlanta some \$30 million in mortgages. That may not be enough ... but we're trying."

On Tuesday, C&S spokesman Dallas Lee said the bank planned to offer \$5 million in home purchase loans, about 125 loans, at 1 percentage point below its normal interest rate. The loans would be available south of Interstate 20 inside the Perimeter. Lee said the loan program was not in response to the newspaper series but had been planned for months.

Wade Mitchell, executive vice president of Trust Company Bank, said: "I think it's obvious that there are problems. All you've got to do is drive through neighborhoods that are not developing and see that the problems exist. I think the financial institutions recognize that and are trying to do something about it."

"I don't take any quarrel with the numbers in [the Journal-Constitution] report," Mitchell said. "Even if they were plus or minus 20 percent, the thrust would be in the same direction. I do take exception, if I'm reading properly between the lines of the report, that the condition exists as it does today because of active racism, bank policy. I think that that is irresponsible, unfair, and it also is untrue. There are no policies that call for redlining and certainly no policies that restrict the race to which any bank that I know anything about can lend money."

I. Owen Funderburg, chairman and chief executive officer of the black-owned Citizens Trust Bank, said: "I think it's institutionalized racism. We have to find an approach to break with that tradition."

Funderburg said after the meet-



# Self-help the aim of non-profit housing corporations

By Bill Dedman  
Staff Writer

Bankers don't like to be the first to risk money in a neighborhood. They are more comfortable if others are taking a risk there, too.

Housing activists around the country are finding ways to make that risk more palatable.

The most popular way to do this is a combination of 1960s liberalism and 1980s Reaganomics. Called a community development corporation (CDC), a non-profit company uses government money and expertise to support private, non-profit efforts at self-help.

In Atlanta, for example, the successful South Atlanta Land Trust, which is redeveloping a Southside neighborhood, was sponsored by a CDC — in Massachusetts, because Atlanta had none.

Something closer to home may be on its way. The Metropolitan At-

lanta Community Development Corp. is being planned by a middle-class white female housing activist and a middle-class black male lawyer.

Lynn Brazen, the housing activist, is an economic development specialist for the Fulton County Department of Planning and Economic Development and a leading banking activist through the Atlanta Community Reinvestment Alliance.

Sherman Golden, the lawyer, is an assistant director of the same department and chairman of The Progressive Alliance, a leading group of young black professionals and executives in Atlanta.

Together they hope a CDC will:

- Help neighborhoods form housing corporations.

- Become a developer, sponsoring projects itself or with others.

- Invest \$1 million in non-profit and for-profit housing efforts.

- Lend \$50 million for single-family and multifamily housing.

A CDC was proposed in 1986 by Mrs. Brazen's reinvestment coalition, which was negotiating with Trust Company Bank over alleged redlining. The bank called other banks together in February 1987 to hear the proposal, but they rejected it.

The banks said they preferred to work on one of the CDC's goals through a loan pool for home loans, although the pool has not yet been formed. And they expressed skepticism about contributing to a development agency they did not control, noting dissatisfaction with previous development efforts to which they had contributed.

So Mrs. Brazen and Golden are starting their own CDC.

They hope it can act as an intermediary between local housing efforts and financiers, providing the

credentials that can take neighborhood groups years to build.

Of the more than 3,000 CDCs nationally, the planners have chosen as a model the Boston Housing Partnership. Formed in 1983, it raised \$37 million to fix up 701 housing units and is working on 1,100 others in a second phase.

So far Golden and Mrs. Brazen have formed a board with members from the city of Atlanta, Fulton and DeKalb counties, Citizens and Southern Bank, Decatur Federal Savings and Loan, housing developers, neighborhood and advocacy groups, and experts in law, insurance, real estate and finance.

Now they need money.

"What we have so far is a clear commitment from the local interest groups and the governments," Golden said. "What is not clear is the level of commitment from the banks and the corporations and the foundations. That is the hurdle."

ing that "a couple dozen" new accounts have been opened at his bank this week by former depositors at white-owned banks.

Several council members said banks redline, an illegal practice of refusing to do business in minority areas.

Councilman Archie Byron: "The article is accurate. We experience a lot of redlining in our district. When I moved to Bankhead Highway ... a banker said, 'Byron, I'm sorry, you can't get the help you need. The area's redlined.'"

Councilman Hosea Williams: "First, we've really got to admit to ourselves that this problem exists, not sweep it under the rug. There's no greater problem that faces black folks, including drugs and AIDS, than economic deprivation. We're being cheated, and we didn't just start being cheated."

Councilman Jabari Simama: "It's not personal. You can be a great guy. You can love Bill Cosby and all of that. But it's embedded in some historical structures that have developed within the institutions. We need to come up with some real, substantive solutions. I don't want a pot of money that will appease people for a couple of months or a couple of years."

Councilman Thomas Cuffie: "[The lending pattern] is not surprising to me. And I don't think it's surprising to bankers or the community or elected officials either. It's just that it's been empirically validated."

Commission Chairman Lomax: "I've been disappointed, I might say, by some of the responses that have occurred over the last couple of days, and I'm heartened today to see so many of the banks represented. I feel that the banks really do owe not only affirmative action in regard to this but an apology to the city as a whole for what has gone on, whether they've known about it or not. And I think they owe us an apology for some of the characterizations they've made of the black community."

County Commissioner Joyner: "Just in these newspaper articles, there is enough information for the U.S. Justice Department, if we push, to bring federal lawsuits for housing discrimination against every bank that has not shown community reinvestment as required by the law."

Shinhoster of the NAACP: "If lending policies and practices do not change substantially to meet the concerns and demands of the black consumer market, then withdrawing funds from recalcitrant banks and banks with poor policies would be a logical step to take. Economic withdrawal makes sense."

Several Southside residents and business executives attended the city meeting to say they had been turned down for loans because of redlining. One man held a sign: "Want to be an Atlanta bank president? Here's the only tool of the trade you need — a red pencil!"

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Social Responsibility in Bank Credit Decisions: The  
Community Reinvestment Act One Decade Later

*Robert C. Art*

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## **Social Responsibility in Bank Credit Decisions: The Community Reinvestment Act One Decade Later**

ROBERT C. ART\*

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Modifying the behavior, attitudes, and norms of the banking industry and of banking regulatory agencies, in relation to issues of social responsibility, is an accomplishment of major proportions. The Federal Community Reinvestment Act,<sup>1</sup> enacted in 1977 with that ambitious goal, has succeeded to a significant extent, and is likely to become increasingly important in coming years. The decade that has elapsed since 1977 provides a basis for assessment of the approach, the numerous inherent flaws, and the successes of the Act.

A vociferous public debate in many urban areas in the mid-1970s focused on the issue of whether banks and other financial institutions that accumulated deposits in neighborhoods having lower-income or racial minority residents owed any responsibility to make mortgage loans available in those neighborhoods. Is it necessary, or even proper, for a depository institution to adopt, as a goal of its overall lending policy, the objective of affirmatively contributing to the economic health of particular neighborhoods? Prior to 1977, the answer to the banking industry was a resounding and unequivocal "No."<sup>2</sup> The federal regulatory authorities fully supported and encouraged the conviction of bankers that financial safety and profitability of depository institutions were the only acceptable goals, regardless of the effect on surrounding communities.<sup>3</sup>

1. 12 U.S.C. §§ 2901-2909 (1982). The Community Reinvestment Act (C.R.A.) is Title VIII of the Housing and Community Development Act of 1977, Pub. L. No. 95-128, 91 Stat. 1147 (1977).

2. *Community Credit Needs: Hearings on S. 406 Before the Comm. on Banking, Housing, and Urban Affairs*, 95th Cong., 1st Sess. (1977) [hereinafter referred to as *Hearings on S. 406*]. See, e.g., statements in opposition to enactment of C.R.A. submitted by the National Savings and Loan League, *id.* at 279-80; the American Bankers Association, *id.* at 314; the National Association of Mutual Savings Banks, *id.* at 334; and the United States League of Savings Associations, *id.* at 366, 368.

3. See *infra* note 52. *Hearings on S. 406*, *supra* note 2, at 14, 15 (statements in opposition to enactment of C.R.A. submitted by Arthur F. Burns, Chairman of the Federal Reserve

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Community groups were incensed with this lack of concern for the social effects of institutional credit decisions. They pointed to evidence that many depository institutions systematically denied loans to creditworthy individuals residing in disfavored neighborhoods, and that the practice was often closely correlated with racial discrimination.<sup>4</sup> Some activists attributed malevolence and responsibility for deterioration of neighborhoods to depository institutions.<sup>5</sup> Many people called for mandatory lending in neighborhoods from which deposits were drawn<sup>6</sup>—proposals which the banking industry argued would be unworkable, counterproductive, and financially disastrous.<sup>7</sup>

The resulting legislation rejected both extremes. The Community Reinvestment Act (C.R.A.) carefully avoided rigid government credit allocation.<sup>8</sup> It sought instead to modify the attitudes and orientations of decision-makers in the banking industry and federal supervisory agencies. The Act resolved the dispute over principles and required good-faith efforts to improve lending practices.<sup>9</sup> In an age in which government regulation commonly took the form of detailed requirements, quotas, and timetables, C.R.A. followed a very different model. It established a direction and goal, and then allowed private industry latitude and discretion in choosing methods to attain the goal.

The mechanism for enforcement was to be "encouragement" from the federal agencies that routinely supervised depository institutions in detail, together with a significant economic sanction for continued refusal to respond favorably to the "encouragement."<sup>10</sup> A financial

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Board and Robert E. Barnett, Chairman of the Federal Deposit Insurance Corporation (F.D.I.C.)). The traditional views of the agencies are discussed in greater detail in *infra* notes 133-38 and accompanying text. The similarity of views between federal regulators and the regulated institutions may be partially due to the fact that the agencies' governing boards are frequently elected by the institutions, and their funding is derived from the institutions. See Note, *Legislating Against Mortgage Credit Redlining: The Need for a Firmer Commitment*, 12 RUTGERS L.J. 151, 178-79 (1980).

4. See *infra* note 24 and accompanying text.

5. The tenor of the accusations is described and analyzed in, e.g., Marcuse, *The Deceptive Consensus on Redlining: Definitions Do Matter*, 45 J. AM. PLAN. A. 549 (1979); Lucey, *The Redlining Battle Continues: Discriminatory Effect v. Business Necessity Under the Fair Housing Act*, 8 B.C. ENVTL. AFF. L. REV. 357, 359-63 (1979); W. DENNIS & J. POTTINGER, *FEDERAL REGULATION OF BANKING: REDLINING AND COMMUNITY REINVESTMENT: ANALYSIS, COMMENTARY AND COMPLIANCE PROCEDURES 1-5 TO 1-7* (1980).

6. See *infra* notes 44 & 46 and accompanying text.

7. See *infra* note 47.

8. See *infra* note 43.

9. 12 U.S.C. §§ 2901-2903 (1982).

10. C.R.A. states in part: "The Congress finds that . . . regulated financial institutions have continuing and affirmative obligation [sic] to help meet the credit needs of the local



institution that refused to act to improve its record of serving the credit needs of its entire community, including low- and middle-income residents, could be denied permission to open new branch offices, relocate offices, merge, or complete any of a number of other transactions that routinely require regulatory approval.<sup>11</sup>

The effect of C.R.A. has been uneven, with marked variations among the different branches of the financial services industry<sup>12</sup> and the four separate federal regulatory agencies, which include the Federal Reserve,<sup>13</sup> Comptroller of the Currency,<sup>14</sup> Federal Home Loan Bank Board,<sup>15</sup> and Federal Deposit Insurance Corporation.<sup>16</sup> For example, the Federal Home Loan Bank Board (which supervises savings and loan associations) appears to have fully accepted its responsibilities, while the Federal Reserve Board (which regulates commercial banks) retains strong ideological resistance to the goals

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communities in which they are chartered." 12 U.S.C. § 2901(a)(3) (1982) (emphasis added). C.R.A. also instructs the supervisory agency to "encourage such institutions" to help meet the local community needs. 12 U.S.C. § 2901(b) (1982). The agencies are further instructed to "assess the institution's record of meeting the credit needs of its *entire* community, including low- and moderate-income neighborhoods . . .," and to "take such record into account in its evaluation of an application for a deposit facility . . ." 12 U.S.C. § 2903 (1982) (emphasis added). The agencies understandably had difficulty determining whether a difference existed between "local" and "entire" communities, and finally determined that no distinction was intended. The mandatory language of the Act is directed exclusively to the agencies, not the depository institutions, but the plainly apparent sanctions apply to the institutions, not to the agencies. No definition of "credit needs" or "community" is to be found in the Act. Depository institutions are expected "to help meet credit needs," but no information is provided covering specifically the method or degree of help, and the goal is qualified by the clause "consistent with safe and sound operation of such institution[s]." 12 U.S.C. §§ 2901(b), 2903(1) (1982). See also *infra* note 58 and accompanying text.

11. See 12 U.S.C. § 2902(3) (1982). The list includes applications for a new federal charter, deposit insurance, establishment of a new branch, relocation of an office, merger consolidation, and acquisition of assets or shares in another regulated institution. A few types of changes in operation by financial institutions are not included, such as closing an office, and entry into the Federal Reserve System.

12. See 12 U.S.C. §§ 2902-2905 (1982). Not all depository institutions are included within the categories covered by the Act. Notably absent are credit unions, many of which are regulated by the National Credit Union Administration.

13. The Board of Governors of the Federal Reserve System regulates bank holding companies and state-chartered commercial banks which are members of the System. 12 U.S.C. § 2902(1)(B) (1982).

14. The Comptroller of the Currency regulates national banks. 12 U.S.C. § 2902(1)(A) (1982).

15. The Federal Home Loan Bank Board regulates savings and loan associations and savings banks whose deposits are insured by the Federal Savings and Loan Insurance Corporation (including all federally-chartered associations), and savings and loan holding companies. 12 U.S.C. § 2902(1)(D) (1982).

16. The Federal Deposit Insurance Corporation regulates state chartered commercial banks and savings banks whose deposits the Corporation insures but which are not Federal Reserve System members. 12 U.S.C. § 2902(1)(C) (1982).

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of C.R.A.<sup>17</sup> The primary force for change has not been the agencies themselves, but rather community groups which have accrued important new leverage in negotiations with depository institutions.<sup>18</sup>

In analyzing the significance and effects of the C.R.A., this article begins with the underlying controversy over "redlining" and "credit allocation," and then discusses the standards and the enforcement process created by the Act and regulations. Separate treatment is accorded to each of the primary actors in the process: community groups, depository institutions, and federal supervisory agencies. Finally, the article reflects on prospects for the future of C.R.A. in an age of bank deregulation, and concludes that the significance of C.R.A. will increase rather than diminish.

#### I. POLICY CONSIDERATIONS: THE PROBLEM OF "REDLINING" AND THE SPECTER OF "CREDIT ALLOCATION"

Decisions of private lending institutions can have a major impact on communities. A spokesperson for the banking industry has described the availability of mortgage credit as "the lifeblood of the neighborhood," and "absolutely essential for neighborhood preservation or improvement."<sup>19</sup> Unavailability of private financing is correlated with depressed housing prices, disrepair, reduced incidence of owner-occupied dwellings, and ultimately a stigma as a declining neighborhood. This stigma is exceedingly difficult to overcome and may lead to further serious deterioration.<sup>20</sup> Federal lending or mortgage insurance does not provide an adequate or effective alternative

17. The records of each of the four regulatory agencies are discussed and compared in part V of this Article.

18. See part III of this Article, discussing the role of community groups, and part IV, section A, analyzing the pragmatic pressures imposed on depository institutions to modify their lending policies.

19. Van Alstyne, *Redlining—The Cure Worse Than the Illness*, 3 J. CONTEMP. L. 264, 269 (1977). Accord D. LISTOKIN & S. CASEY, *MORTGAGE LENDING AND RACE: CONCEPTUAL AND ANALYTICAL PERSPECTIVES OF THE URBAN FINANCING PROBLEM* 5 (1980); Memorandum Regarding the Policies and Practices of the Federal National Mortgage Association (F.N.M.A. Nov. 1977), cited in Dennis, *The Dual Housing Credit Market*, in *DISCRIMINATION IN MORTGAGE CREDIT: REGULATION, LITIGATION, AND COMPLIANCE* 297, 351 (W. Dennis & D. Glascoff, Jr., eds., Prac. L. Inst. 1979) [hereinafter cited as Dennis, *The Dual Housing Credit Market*].

20. See, e.g., H.R. REP. NO. 634, 95th Cong., 1st Sess. (1977). See also Fefferman, *The Redlining of Neighborhoods by Mortgage Lending Institutions and What Can Be Done About It*, in *REDLINING: A SPECIAL REPORT BY FNMA* 25, 27 (Jan. 1976); Duncan, Hood & Neet, *Redlining Practices, Racial Resegregation, and Urban Decay: Neighborhood Housing Services as a Viable Alternative*, 7 URB. LAW. 510, 511 (1975); Phillips & Bryson, *Refinancing: A First Step Toward a Realistic Housing Program for the Poor*, 39 GEO. WASH. L. REV. 835 (1971); Renne, *Eliminating Redlining by Judicial Action: Are Erasers Available?*, 29 VAND. L. REV. 987 (1976).

to private credit, and in fact has at times become part of the problem rather than part of the solution to neighborhood deterioration.<sup>21</sup>

The controversy leading to enactment of C.R.A. focused on "redlining"<sup>22</sup>—a term based on the imagery of a financial institution management designating, by red lines on a city map, neighborhoods in which credit will be denied or will only be granted on a discriminatory basis.<sup>23</sup> Subsumed within the term as commonly used are at

21. Federal lending is a small fraction of the total mortgage credit market. At the end of 1984, all federal agencies, including the Federal Housing Administration, and the secondary market agencies such as Federal National Mortgage Authority held only \$158 billion in mortgage debt (less than the holdings of mutual savings banks, the smallest category of depository institution), as compared to \$2.0 trillion held by all lenders. Fed. Res. Bd., *Financial and Business Statistics*, Table 1.54, Mortgage Debt Outstanding, 71 Fed. Res. Bull. A39 (June 1985). Moreover, federal programs can have counterproductive results. The F.H.A., for example, liberalized its underwriting standards and created a high-risk insurance fund to promote loans in urban areas faced with deterioration. 12 U.S.C. §§ 1715e, f, 1735c (1982). In operation, the program has in many instances promoted a cycle of bad loans, fast foreclosures, and neighborhood deterioration. Because lenders are relieved of risk, they have no incentive to assure that borrowers are creditworthy, or to allow a defaulting borrower to cure. To the contrary, "points" paid in advance have the effect of providing a premium to lenders who, after originating an F.H.A. loan, can quickly declare a default, collect on F.H.A. insurance, then lend the money again, and thus earn additional "points." Kratovil, *Mortgage Law Today*, 13 J. MARSHALL L. REV. 251 (1980). J. KUSHNER, *FAIR HOUSING: DISCRIMINATION IN REAL ESTATE COMMUNITY DEVELOPMENT AND REVITALIZATION* 282-85 (1983); Memorandum regarding the Policies and Performance of the Federal National Mortgage Association, Comm. Print, Senate Comm. on Banking, Housing & Urban Affairs, 95th Cong., 1st Sess. (Nov. 22, 1977), *excerpt reprinted in* W. DENNIS & J. POTTINGER, *supra* note 5, at 1-9; B. BOYER, *CITIES DESTROYED FOR CASH* 11 (1973), *cited in* Note, *Attacking the Urban Redlining Problem*, 56 B.U.L. REV. 989, 1003 (1976). *See also* Duncan, Hood & Neet, *supra* note 20, at 519-20. One study found lenders to be seven times more likely to foreclose on F.H.A. loans than on conventional loans. GOV. COMM'N ON MORT. PRACS., *REPORT ON HOME OWNERSHIP IN ILLINOIS—THE ELUSIVE DREAM* 54 (1974), *cited in* Note, *supra*, at 1003. The effect of fast foreclosure of F.H.A. mortgages has been so devastating in many urban neighborhoods that F.H.A. programs are widely viewed as part of the problem of neighborhood deterioration rather than part of the solution. M. PRZYBYLSKI, *PERCEPTIONS OF RISK: THE BANKER'S MYTH: AN EIGHT CITY SURVEY OF MORTGAGE DISCLOSURE DATA* 237-38 (Nat. Train. & Info. Ctr. 2d ed. 1978); Mort. Bankers Ass'n of Am., Task Force, *Redlining: Solution Requires Unified Approach II* (undated), *reprinted in* MORTGAGE BANKER 46 (Apr. 1977) [hereinafter cited as M.B.A.A. Task Force, *Redlining*]; TRI-STATE REGION. PLAN. COMM'N, "GREENLINING" URBAN NEIGHBORHOODS: A RECONNAISSANCE OF ANTIREDLINING REFORMS IN NEW YORK, NEW JERSEY AND CONNECTICUT AND SOME SUGGESTIONS FOR FUTURE ACTIONS 4 (Inter. Tech. Rep. 3402 Jan. 1981) [hereinafter cited as TRI-STATE, *GREENLINING*]. Reliance entirely on public participation is unsatisfactory for reasons which extend beyond the administrative problems of F.H.A. Large quantities of government subsidized credit in a neighborhood can create a stigma—an indication of excessive risk, further increasing the reluctance of depository institutions to extend conventional credit. W. DENNIS & J. POTTINGER, *supra* note 5, at 9-72.

22. McCluskey, *The Community Reinvestment Act: Is It Doing the Job?*, 100 BANKING L.J. 33 (1983); Note, *Automated Teller Machines Under the New York Banking Law: Do They Serve Community Credit Needs?*, 37 SYRACUSE L. REV. 117, 139-42 (1986). Redlining is discussed at length in the legislative history. *See, e.g.*, SENATE COMM. ON BANKING, HOUSING, & URBAN AFFAIRS, *REPORT ON THE HOUSING AND COMMUNITY DEVELOPMENT ACT OF 1977*, S. REP. NO. 175, at 34 [hereinafter cited as S. REP. NO. 175].

23. Senator Proxmire, the Congressional sponsor of C.R.A., intended the Act to address

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least three elements that, though often closely related, are conceptually distinct: racial and ethnic discrimination, geographic discrimination, and neighborhood disinvestment.

### A. Racial Discrimination

Discrimination against racial and ethnic minorities is the aspect of redlining that is most offensive to public policy and that has received the earliest and most thorough legislative attention. Studies in at least a dozen cities have demonstrated that redlining has a disproportionately high impact on minority groups, even after accounting for legitimate risk factors and differences in demand for loans.<sup>24</sup>

For long periods in our country's history, institutional lenders routinely denied applications for mortgage credit in areas that were racially integrated or considered to be threatened by integration. Such discrimination was widely accepted as legitimate—mandated by the fiduciary duty owed by financial institutions to their depositors and shareholders.<sup>25</sup> Generally-accepted appraisal standards downgraded

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redlining, and explained:

By redlining let me make it clear what I am talking about. I am talking about the fact that banks and savings and loans will take their deposits from a community and instead of reinvesting them in that community, they will invest them elsewhere, and they will actually or figuratively draw a red line on a map around the areas of their city, sometimes in the inner city, sometimes in the older neighborhoods, sometimes ethnic and sometimes black, but often encompassing a great area of their neighborhood.

123 CONG. REC. S8958 (daily ed. June 6, 1977). Reference to red lines on a city map is common in the real estate credit literature. See, e.g., Fefferman, *supra* note 20, at 26; Badain, *Insurance Redlining and the Future of the Urban Core*, 16 COLUM. J.L. & SOC. PROBS. 1, 4 (1980); Bowsher, *The Three-Year Experience with the Community Reinvestment Act*, 64 FED. RES. BANK ST. LOUIS REV., Feb. 1982, at 3; W. DENNIS & J. POTTINGER, *supra* note 5, at 1-4.

24. See, e.g., R. SCHAFER & H. LADD, *DISCRIMINATION IN MORTGAGE LENDING* 287, 292-300 (1981); Phillips & Bryson, *supra* note 20; G. STERNLIEB, *THE TENEMENT LANDLORD* 107-19 (1966); *Home Mortgage Disclosure Act of 1975: Hearings on S. 1281 Before the Comm. on Banking, Housing & Urban Affairs*, 94th Cong., 1st Sess. 1063, 1267 (1975).

25. This attitude was expressed, for example, in a public statement of the Chairman of the F.D.I.C. in 1961:

There exists a possibility that the financing of a real estate purchase for a member of a minority group might have a serious effect upon values in a neighborhood. If the bank already had a substantial number and dollar volume of mortgage loans in the neighborhood, it would necessarily consider the effect upon those assets . . . . [E]very bank has a moral, as well as a legal, obligation and responsibility toward the economic welfare of its depositors and stockholders.

W. DENNIS & J. POTTINGER, *supra* note 5, at 2-7 (citing U.S. COMM'N ON CIVIL RIGHTS, HOUSING (1961)). A spokesman for the Mortgage Bankers Association of Metropolitan Washington stated that: "Applications from minority groups are not generally considered in areas that are not recognized as being racially mixed, on the premise that such an investment would be unattractive to institutional lenders." *Id.* (citing U.S. COMM'N ON CIVIL RIGHTS, USA, HOUSING IN WASH., D.C., 467 (1962)).

areas "infiltrated" by minority groups.<sup>26</sup> The federal government, acting through such agencies as the Federal Housing Administration,<sup>27</sup> supported and promoted the proposition that the loss of ethnic homogeneity inevitably resulted in loss of property values.<sup>28</sup> That

26. The mode of expression of race-based appraisal policies became increasingly veiled, but the underlying assumptions remained, as indicated by a study tracing the code phrases used for race in various editions of a widely used text, *The Appraisal of Real Estate*, published by the American Institute of Real Estate Appraisers. The 1935 edition stated that "infiltration" by "colored people" inevitably led to decline in property values. The term used in 1938 was "inharmonious racial group," and in 1960, "people of a lower economic status and different social and cultural background." In 1975 reference was made to a "shift in the economic, social and physical forces creating the environment," a clause that is both apparently neutral and impenetrably vague. Two years later, however, in 1977, training materials issued by the appraisal institute contained, as an example of appropriate appraisal analysis, the following: "The neighborhood is entirely Caucasian. It appears that there is no adverse effect by minority groups." Discriminatory references were finally removed as a result of an agreement settling a lawsuit brought by the Department of Housing and Urban Development. THE POTOMAC INST., INC., METRO. HOUS. PROGRAM, LENDER'S GUIDE TO FAIR MORTGAGE POLICIES (1980). For terms of the settlement, see *United States v. American Institute of Real Estate Appraisers of the Nat'l Ass'n of Realtors*, 442 F. Supp. 1072 (N.D. Ill. 1977), *aff'd*, 590 F.2d 242 (7th Cir. 1978). The appraisers' standards were held to violate the Fair Housing Act.

27. The F.H.A., operating a mortgage insurance program designed to relieve lenders of risk, was not itself willing to accept the risk of integration. Mandating that all insurable mortgages be "economically sound," F.H.A. instructed its appraisers in 1938 to: investigate areas surrounding the location to determine whether or not incompatible racial and ethnic social groups are present, to the end that an intelligent prediction can be made regarding the possibility or probability of the location being invaded by such groups . . . . A change of social or racial occupancy leads to instability and a reduction in values.

FED. HOUS. ADMIN., UNDERWRITING MANUAL §§ 935, 937 (1938). As an additional safeguard, F.H.A.'s underwriting standards during the 1930s and 1940s recommended racially restrictive covenants in the deeds of homes with F.H.A. mortgages. *Id.* § 980(3)(g). See also J. KUSHNER, *supra* note 21, at 265, 282; Sloane, *Federal Programs and Equal Housing Opportunity*, in *Subcomm. on Constitutional Rights, Senate Comm. on the Judiciary, Civil Rights*, 94th Cong., 2d Sess. at 135 (Comm. Print 1976), cited in Note, *The Community Reinvestment Act Regulations: Another Attempt to Control Redlining*, 28 CATH. U.L. REV. 635 (1979); Dennis, *The Dual Housing Credit Market*, *supra* note 19, at 302-03; Duncan, Hood & Neet, *supra* note 20, at 517; Note, *Is the U.S. Committed to Fair Housing? Enforcement of the Fair Housing Act Remains a Crucial Problem*, 29 CATH. U.L. REV. 641, 646-47 (1980).

28. Racial integration was almost uniformly assumed, by both the private sector and federal agencies, to produce loss of property value, and risk of mortgage default. Dennis, *The Dual Housing Credit Market*, *supra* note 19, at 302-05; Lamb, *Housing Discrimination and Segregation in America: Problematical Dimensions and the Federal Legal Response*, 30 CATH. U.L. REV. 363, 371 (1981); see U.S. DEPT. OF HOUS. & URB. DEV., *THE DYNAMICS OF NEIGHBORHOOD CHANGE* (1975), reproduced in MORT. BANKERS ASS'N OF AM., *FINAL REPORT OF THE REDLINING TASK FORCE*, in *Hearings on S. 406*, *supra* note 2, at 406, 412; FEDERAL RESERVE SYSTEM COMPLIANCE MANUAL I.1.10-11; J. GUTTENTAG & S. WACHTER, *REDLINING AND PUBLIC POLICY* (N.Y.U. Sch. of Bus. Monograph 1980-1) (citing several additional studies); see also D. LISTOKIN & S. CASEY, *supra* note 19, at 7. Standard appraisal techniques not only assumed that racial homogeneity was essential to maintain property values but, as recently as 1975, also provided "rankings of races and nationalities with respect to their beneficial effect on land values." McMICHAEI'S APPRAISING MANUAL (1975), cited in FEDERAL RESERVE SYSTEM COMPLIANCE MANUAL I.1.12; TRI-STATE, *GREENLINING*, *supra* note 21. Until 1950, the Code of Ethics of the National Association of Real Estate Boards (Realtors) provided that: "A



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assumption, when pervasively accepted, can become a self-fulfilling prophecy.<sup>29</sup>

Current federal legislation, of course, prohibits racial discrimination in housing credit, the most direct statutes being the Equal Credit Opportunity Act of 1977<sup>30</sup> and the Fair Housing Act of 1968.<sup>31</sup> Nevertheless, the attitudes and assumptions of financial institutions, developed over many decades of officially sanctioned racial discrimination in mortgage credit policy, realistically will not change quickly. Although C.R.A. does not directly address racial discrimination, its purpose and effects are consistent with the statutes prohibiting discrimination, because allegations of failure to meet the credit needs of a community are frequently correlated with allegations of racial discrimination.<sup>32</sup>

### B. Geographic Discrimination

A second element of the redlining controversy, and the one most directly addressed by C.R.A., is discrimination that focuses not directly on the race of the applicant for a mortgage loan but rather

realtor should never be instrumental in introducing into a neighborhood . . . members of any race or nationality, or any individuals whose presence will clearly be detrimental to property values in that neighborhood." Quoted in *Zuch v. Hussey*, 394 F. Supp. 1028, 1055 (E.D. Mich. 1975); *United States v. School Dist.*, 521 F.2d 530, 534 (8th Cir. 1975).

29. If enough residents of a white neighborhood, panicked by the entry of a few minority families, put their homes on the market in a short period of time, prices will be depressed. Faced with this situation—or even the expectation of it—"prudent" lenders redline, thereby making sales at the previously high prices impossible. The value of property in the neighborhood does indeed decline, thereby realizing the worst fears of the "prudent" lenders. See, e.g., *FEDERAL RESERVE SYSTEM COMPLIANCE MANUAL* I.1.10 (1983); Lamb, *supra* note 28, at 372; R. BRANDEL & M. LARGE, *A COMPLIANCE GUIDE FOR THE COMMUNITY REINVESTMENT ACT: BACKGROUND AND IMPLICATIONS* 8 (Consumer Banker's Ass'n 1978); R. STARR, *HOUSING AND THE MONEY MARKET* 26 (1975); Downs, *An Economic Analysis of Property Values and Race*, 36 *LAND ECON.* 181 (1960); Duncan, Hood & Neet, *supra* note 20, at 517; Note, *supra* note 21.

30. 15 U.S.C. §§ 1691-1691f (1982).

31. 42 U.S.C. §§ 3601-3619 (1982). Racial and ethnic discrimination in housing finance is prohibited. 42 U.S.C. § 3605 (1982). In addition, the Civil Rights Act of 1966, 42 U.S.C. § 1982, granted to all citizens the same rights to buy property as are enjoyed by white citizens. For discussions of the applicability of these Acts to problems of redlining, see Renne, *supra* note 20; Duncan, Hood & Neet, *supra* note 20, at 522; McCluskey, *The Community Reinvestment Act: Is It Doing the Job?*, 100 *BANKING L.J.* 33, 50-53 (1983); Annot., "Redlining," *Consisting of Denial of Home Loans or Insurance Coverage in Certain Neighborhoods, as Discrimination in Violation of* §§ 804 and 805 of Fair Housing Act (42 U.S.C.S. §§ 3604, 3605), 73 *A.L.R. FED.* 899 (1985).

32. See, e.g., New York Public Interest Research Group, *Take the Money and Run! Redlining in Brooklyn* (1977); BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, Order, Ameritrust Corp., Cleveland, Ohio, 66 *FED. RES. BULL.* 238 (1980). The supervisory agencies have stated that violation of Fair Housing and Equal Credit Opportunity regulations are also violations of C.R.A., thereby providing an additional mechanism for enforcement of the older laws. See 12 C.F.R. § 563c.7(f) (1986).



on the location of the proposed collateral. Lenders generalize that all properties within certain boundaries are unlikely to retain their value, and hence are poor security for a loan, without regard to the characteristics of the particular credit applicant or the specific collateral.<sup>33</sup> To compensate for the perceived higher risk,<sup>34</sup> loans in that area are avoided, or are offered on terms less favorable than loans in other areas.

In many respects, of course, location of the proposed collateral is an unavoidably central and inherently reasonable criterion in the credit decision. No reasonable government policy would compel or even encourage private depository institutions to grant mortgage loans on property that is, for example, below a flood plain, on a geologic fault line, or clearly unsuited for its proposed use relative to adjoining properties (such as an apartment house proposed to be built next to a rendering plant).<sup>35</sup>

The problem with unrestrained use of location as a primary criterion in mortgage credit decisions is that, in some instances, discrimination against a particular neighborhood may not be rationally based or, even though rational, may produce results that are socially unacceptable.<sup>36</sup> One clear example would be a decision by depository

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33. One aspect of the geographic discrimination phenomenon has been the traditional bias of both private lenders and federal real estate credit agencies in favor of suburbs, at the expense of urban areas, based on the assumption that neighborhoods inevitably decline as they age. M.B.A.A. Task Force, *Redlining*, *supra* note 21, at 50 ("Because 'healthy' also suggests relatively new, the implication is clear that anything more than a generation old is nearing the end of its 'economic life'"); M. PRZYBYLSKI, *supra* note 21, at 151-56; D. LISTOKIN & S. CASEY, *supra* note 19, at 9.

34. See, e.g., J. GUTTENTAG & S. WACHTER, *supra* note 28; Earthman, *Residential Mortgage Lending: Charting a Course Through the Regulatory Maze*, 29 VAND. L. REV. 957 (1976); Duncan, Hood & Neet, *supra* note 20, at 510; D. LISTOKIN & S. CASEY, *supra* note 19, at 11; Van Alstyne, *supra* note 19.

35. Testimony of William A. Beason, Jr., on behalf of National Association of Mutual Savings Banks, in *Hearings on S. 1281 before Senate Comm. on Banking, Housing, & Urban Affairs*, 94th Cong., 1st Sess. (1975), cited in Note, *Redlining: Should Local Government Become Involved?*, 10 U.C. DAVIS L. REV. 243 (1977); see also Van Alstyne, *supra* note 19, at 269; D. LISTOKIN & S. CASEY, *supra* note 19, at 5. Additional locational factors mentioned by the above sources include abandonment, demolition, and obvious deterioration of structures in a neighborhood, and all tend to depress the value of nearby buildings. Marked deterioration in government services, including street cleaning, building code enforcement, sanitation, schools, etc., and increases in crime, tend to make property in the area less desirable and less valuable.

36. The four agencies agree that disproportionately few loans are made in low- and moderate-income neighborhoods, compared with higher income areas, and that "[f]actors such as housing demand and safety and soundness considerations do not appear to account fully for the extent of these disparities." Fed. Fin. Insts. Exam. Coun., C.R.A. Information Statement, 45 Fed. Reg. 63,133 (1980) [hereinafter cited as F.F.I.E.C., C.R.A. Information Statement] (emphasis added). One economist has defended the use by lending institutions of generalizations based on race and neighborhood as rational, in that it avoids the costs of

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institutions to withhold credit from a neighborhood that was previously all white and displays no objective evidence of physical or economic deterioration, solely because a few middle-class black families have moved in. Another, less apparent, example would be a decision to extend credit only on single-family dwellings, when virtually all of the housing in the area is multiple-family apartment houses.<sup>37</sup>

The debate over whether lending institutions' decisions to withhold mortgage credit initiates, contributes to, or merely responds to neighborhood deterioration is one that has continued for decades,<sup>38</sup> and is not likely ever to be conclusively resolved. Nevertheless, it is clear that the unavailability of private mortgage credit is devastating to a neighborhood's health and its ability to initiate or maintain growth or revitalization.

Geographic discrimination takes a wide variety of forms, the most obvious of which is outright refusal to consider applications for mortgage loans in particular areas. Other forms include imposition of more stringent credit terms for loans in some areas than would be required for a similar loan elsewhere. Examples include larger downpayments, higher interest rates, higher "points" and other loan origination costs, lower loan-to-value ratios, and shorter terms.<sup>39</sup>

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obtaining information specific to the particular loan applicant or the particular collateral. J. GUTTENTAG & S. WACHTER, *supra* note 28. "[I]f black loan applicants have lower income stability than white applicants, and if more definitive information on income stability is costly to obtain, it is not irrational to redline based on color." *Id.* at 14. Rationalizations such as this point up the need to insert social policy judgments as a factor in private credit decisions, and to promote at least minimal standards of equity to individuals from races or neighborhoods disfavored by lenders who purport to be acting rationally.

37. One similar example was the policy of some Bronx banks to lend only on one to four-unit residences and on buildings built after World War II, despite the fact the area was composed overwhelmingly of large prewar apartment buildings. V. BENEDEK, C.R.A.: TEN FIGHTS FOR REINVESTMENT 64 (Nat'l Train. & Info. Ctr. 1980).

38. See, e.g., M.B.A.A. Task Force, *Redlining*, *supra* note 21, at 47 (lenders react to, rather than cause, neighborhood decline); Nelson, *Some Perspectives on Redlining*, in REDLINING: A SPECIAL REPORT BY F.N.M.A. 3, 6-8 (Jan. 1976) (lending practice is only one of many factors involved in neighborhood decline); Wisniewski, *Mortgage Redlining (Disinvestment): The Parameters of Federal State, and Municipal Regulation*, 54 J. URB. L. 367 (1977) (redlining accelerates decline).

39. Discussions of the multiplicity of redlining techniques are included in *Hearings on The Home Mortgage Disclosure Act of 1975*, S. 1281, Before the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. 35 (1975) (testimony of Dan Walker, former governor of Illinois); Renne, *supra* note 20; Phillips & Bryson, *supra* note 20; Searing, *Discrimination in Home Finance*, 48 NOTRE DAME LAW. 1113 (1973); Note, *Urban Housing Finance and the Redlining Controversy*, 25 CLEV. ST. L. REV. 110 (1976); TRI-STATE, GREENLINING, *supra* note 21, at 1-2; Note, *supra* note 21; Lamb, *supra* note 28, at 403.

Many policies which are facially neutral may also have the effect of excluding from consideration disproportionate numbers of loans on properties in certain neighborhoods. For example, imposing a minimum loan amount or maximum age of a building to secure a loan tends to exclude the lower-priced, older buildings which predominate in some urban areas. Some lenders have even specified a minimum building lot width which is wider than most lots in their areas, or have limited their lending to types of structures which are not found in certain neighborhoods. Appraisal techniques may result in a substantially lower appraised value for a building in one location than for similar structures elsewhere, resulting in a smaller loan.<sup>40</sup>

### C. Disinvestment

Central to the redlining controversy that led to C.R.A., but not specifically treated in the Act as enacted, is the concept of "disinvestment"—the removal of financial resources from a community. A major premise of many antiredlining activists is that savings deposited by residents of a neighborhood should remain in that neighborhood in the form of real estate loans.<sup>41</sup> Data was presented to the congressional committee indicating that many institutions "exported" ninety percent or more of the amount of deposits received locally to other neighborhoods, while denying loans to credit-worthy applicants in the neighborhood where the deposit-taking institutions were located.<sup>42</sup> In some cases, not even one percent of the local deposits were reinvested in the same neighborhood.<sup>43</sup> Outrage over this situation was and is central to much antiredlining activism, and undoubtedly contributed to passage of C.R.A.<sup>44</sup> (as is indicated in use of the term *reinvestment* in its title).

40. Lamb, *supra* note 28, at 403.

41. See, e.g., M. PRZYBYLSKI, *supra* note 21, at 192 ("it is clear that the geographic areas that generate a lender's deposits bear a priority claim over other areas for credit services").

42. S. REP. NO. 175, *supra* note 22, at 34 (referring to a Washington D.C. savings and loan association).

43. *Id.* One Chicago lender derived over \$10 million in deposits from certain redlined neighborhoods but failed to make a single loan in those areas. S. REP. NO. 187, 94th Cong., 2d Sess., at 6 (1976). See also V. BENEDEK, *supra* note 37, at 15 (approximately 0.2% of deposits in two savings and loan associations and two banks were returned as loans); N.Y.C. COMM'N ON HUMAN RIGHTS, REDLINING IN THE BRONX: AN ANALYSIS OF MORTGAGE LENDING ACTIVITY BY THE DOLLAR SAVINGS BANK (1978) (0.18% of deposits were lent locally); N.Y.C. COMM'N ON HUMAN RIGHTS, REDLINING IN ROCKAWAY 5 (between 3.3% and 5.8% of deposits were invested in the community); N.Y. PUB. INT. RES. GROUP, SEEING RED: BANK REDLINING IN CENTRAL HARLEM 11 (1979) (reinvestment ratios between 1% and 6%).

44. R. GOLDEN & J. ROSENBERG, CITIZENS RESEARCH GUIDE TO BANK REDLINING (N.Y. Pub. Int. Res. Group 1979); V. BENEDEK, *supra* note 37.

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Disinvestment is closely related to geographic discrimination, but the two nevertheless are conceptually distinct. Disinvestment, but not geographic discrimination, is likely to occur in neighborhoods that are healthy, thrifty, and mature, with low turnover of real estate and low demand for mortgage credit. Thus, surplus savings flow to other areas where the demand is greater. Conversely, geographic discrimination, but not disinvestment, is likely to be present in a neighborhood in which credit-worthy applicants are denied for no justifiable reason and in which savings deposits are very low. Funds from other areas are needed to meet local demand, but are not forthcoming.

#### D. Credit Allocation

One approach to the issues of racial and geographic discrimination and neighborhood disinvestment would be a policy of "credit allocation"—a term nearly as ambiguous and controversial as the term "redlining." The most extreme program of credit allocation would consist of government-mandated extensions of credit to particular types of loans, particular neighborhoods, or even particular borrowers.

At the hearings of the Senate committee that drafted the legislation,<sup>45</sup> many community groups focusing on the disinvestment issue demanded a requirement that financial institutions invest in a particular neighborhood some proportion of the deposits received from that neighborhood. Early drafts of the bill were not quite so restrictive, but did mandate lending in what was termed the "primary savings service area" of the depository institution.<sup>46</sup> Predictably, the banking industry attacked that proposal as an unworkable and excessive intrusion into private credit decisions,<sup>47</sup> and the proposal was abandoned.<sup>48</sup>

45. All congressional committee drafting and consideration of C.R.A. took place before the Senate Banking Committee. See *Hearings on S. 406*, *supra* note 2; S. REP. NO. 175, *supra* note 22. The House of Representatives held no hearings on C.R.A., and there were no comparable provisions in the House version of the 1977 Housing & Community Development Act (of which C.R.A. is a part). W. DENNIS & J. POTTINGER, *supra* note 5, at 9-10.

46. See S. 406, 95th Cong., 1st Sess. (1977), reprinted in *Hearings on S. 406*, *supra* note 2, at 3. "Primary savings service area" was defined as a "compact area contiguous to a deposit facility from which such facility obtains or expects to obtain more than one-half of its deposit customers." *Id.* § 3(4); S. REP. NO. 175, *supra* note 22, at 60.

47. Bankers, bank regulators, and some senators argued that the approach was too rigid and raised the threat of credit allocation and unsound lending practices. See *Hearings on S. 406*, *supra* note 2, at 314-15 (statement of A.A. Milligan, on behalf of American Bankers Association), 12 (letter from Comptroller of the Currency); Additional Views of Senators Morgan, Tower, Garn, Lugar, and Schmitt, in S. REP. NO. 175, *supra* note 22, at 81-85. An additional objection was that focusing on ratios of local deposits to local loans would not

Less extreme forms of credit allocation, however, are so well-established they are no longer controversial. The government in many ways promotes results which would not occur in the economists' hypothetical free market. Residential real estate finance has been a particular favorite of the federal government. The Federal Home Loan Bank Act<sup>49</sup> established our system of savings and loan associations for the primary purpose of providing residential real estate loans.<sup>50</sup> Originally, in fact, savings and loan associations were restricted to lending exclusively on real estate within a very short geographic radius of a deposit-taking office.<sup>51</sup>

Secondary market agencies such as the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Association ("Freddie Mac") were established to divert capital into real estate finance that otherwise would be invested in other sectors of the economy.<sup>52</sup> The Federal Housing Administration and the Veterans Administration home loan programs are further examples of government involvement in real estate finance for purposes that are considered socially desirable.

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benefit some of the neighborhoods that were most in need of increased lending, and also too poor to deposit enough funds to meet their own housing credit needs. Also, it was argued, focusing on the extent of lending near deposit-taking offices would permit or even encourage lenders to maintain offices only in wealthy neighborhoods. See *Hearings on S. 406, supra* note 2, at 251, 265 (statement of Garth Marston, Chairman of F.H.L.B.B.), 15 (letter from F.D.I.C.), 294 (statement of M. Todd Cooke, president of Philadelphia Savings Fund Society), 299 (statement of Ronald Grzywinski, a Chicago banking executive).

48. The Senate Committee Bill, S. 1523, 95th Cong., 1st Sess. §§ 401-406 (1977), imposed no ratios but did refer to "primary savings service area." *Id.* § 404(1); S. REP. No. 175, *supra* note 43, at 60. The Conference Committee Bill, H.R. 6655, 95th Cong., 1st Sess. §§ 801-806 (1977), substituted the phrase "entire community." *Id.* § 804(1). For analysis of this aspect of the legislative history, see McCluskey, *supra* note 31, at 38-41.

49. Federal Home Loan Bank Act of 1932, Pub. L. No. 73-304, 47 Stat. 725 (1932) (codified in scattered sections of Titles 12 and 18 of the United States Code).

50. According to Garth Marston, Chairman of the F.H.L.B.B., "Congress has long since determined that the nation's mortgage credit and housing needs are well served by the creation and support of specialized housing credit financial institutions, the savings and loan industry." *Hearings on S. 406, supra* note 2, at 239, 242.

51. *Id.* at 239, 246 (prepared Statement of Garth Marston, Chairman, F.H.L.B.B.). Mortgage lending by a federal thrift institution was limited to real estate within 50 miles of its home office, until amendments to the Act in 1964 raised the limit to 100 miles. Pub. L. No. 88-560, § 901a, 78 Stat. 769 (1964). Further amendments in 1970 added the language "or within the State in which such home office is located," Pub. L. No. 91-351, §§ 706, 709, 84 Stat. 450 (1970), and in 1978 eliminated the geographic restriction, Pub. L. No. 95-630, § 1701, 92 Stat. 3641 (1978). See 12 U.S.C.A. § 1464 Historical Note (1980).

52. Moran, *The Federally Sponsored Credit Agencies: An Overview*, 71 Fed. Res. Bull. 375 (1985) (describing the Federal Home Loan Banks, Fannie Mae, Freddie Mac, and similar agencies). "The sponsored agencies are expected to facilitate a more desirable outcome at times when market forces might allocate credit in ways that are not socially optimal." *Id.*



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Whether such federal efforts are properly designated as "credit allocation" is a matter of interpretation. Clearly, however, the concept of federal government influence on private credit decisions originated many decades prior to the Community Reinvestment Act of 1977.

### II. A NEW MANDATE: THE ACT AND ITS ENFORCEMENT PROCESS

#### A. *The Legislative Concept and Requirements*

The C.R.A. was a compromise between the demands of community groups for rigid credit allocation and the denial by bankers and regulators that any problem meriting legislative attention existed. More importantly, it was an effort to guide private investment decisions in a manner deemed socially responsible, while avoiding the economic inefficiencies and bureaucratic intrusiveness of some federal regulatory schemes. Congress sought to preserve private control over specific private institutional lending decisions, but to influence the attitudes, norms, and behavior of the decision-makers.

The brief two-page Act imposed no formulas, quotas, or specific standards. The primary congressional sponsor of C.R.A. stated explicitly that no rigid form requirements of credit allocation were intended.<sup>53</sup> Instead, the legislation announced the previously controversial principle that "regulated financial institutions have continuing and affirmative obligation [sic] to help meet the credit needs of the local communities in which they are chartered."<sup>54</sup> The four federal supervisory agencies were directed to "encourage" those institutions to conform to that principle, "consistent with the safe and sound operation of such institutions."<sup>55</sup> The core of the C.R.A. is the following provision:

In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall—

- (1) Assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of each institution; and

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53. Senator Proxmire, the primary congressional sponsor of C.R.A. stated: "this was not a credit allocation plan and I certainly don't see it that way. Whatever we can do to prevent it from being a credit allocation bill I want to do." *Hearings on S. 406, supra* note 2, at 154.

54. 12 U.S.C. § 2901(a)(3) (1982).

55. 12 U.S.C. § 2901(b) (1982).



- (2) Take such record into account in its evaluation of an application for a deposit facility by such institution.<sup>56</sup>

This formulation obviously is vague and imprecise. The terms "credit needs" and "entire community" are not defined. The phrase "consistent with safe and sound operation" leaves the door wide open for assertions by depository institutions that any greater lending in its community would be unsafe and unsound. The direction to the agencies to "take such record into account" permits the agencies to approve applications for deposit facilities despite a finding that an institution is *not* meeting the credit needs of its community, if other considerations militate in favor of approval.<sup>57</sup> No specific conduct by financial institutions is either directly prohibited or directly required.

Because of these characteristics, C.R.A. is routinely lambasted by its critics as being so vague as to be nearly meaningless. Nearly every commentator discussing C.R.A. points out its lack of specificity.<sup>58</sup>

Those criticisms are accurate, as far as they go, but they overlook the central significance of C.R.A. The Act settled the core philosophical dispute over whether depository institutions enjoying the benefits of federal charters and federal deposit insurance<sup>59</sup> owe any duty to consider the impact on neighborhoods when determining its lending policies. The C.R.A. was a legislative mandate for a change in policy and an unmistakable rebuke to financial institutions and the federal supervisory agencies that had previously sanctioned and even encouraged redlining.<sup>60</sup>

56. 12 U.S.C. § 2903 (1982).

57. The Federal Reserve Board has stated explicitly that such factors may result in approval of a bank's application despite an unsatisfactory C.R.A. record. *Information Statement Re Community Reinvestment Act*, 66 Fed. Res. Bull. 30 (1980).

58. Commentaries on the Act routinely note the lack of specificity. See, e.g., Healey, *A Banker's Guide to the Community Reinvestment Act*, 96 BANKING L.J. 705, 707 (1979) (vagueness prompts speculation as to how the Act will be interpreted and enforced); W. DENNIS & J. POTTINGER, *supra* note 5, at 9-12 ("CRA itself is somewhat vague and ambivalent on its face"); T. BUYNAK, *THE COMMUNITY REINVESTMENT ACT: EARLY EXPERIENCE AND PROBLEMS: ECONOMIC COMMENTARY 2* (Fed. Res. Bank Clev. Apr. 20, 1981) ("CRA lacks specific direction"); R. BRANDEL & M. LARGE, *supra* note 29, at 4 ("no definite guidance as to precisely what is to be achieved" and no "standards of conduct"); McCluskey, *supra* note 31, at 33; Note, *supra* note 22, at 130-32.

59. Among other benefits, federally supervised depository institutions are protected from competitive forces by federal restrictions on entry into the industry and federal ceilings on interest rates that may be paid on savings accounts. They have access to low-cost credit through the Federal Reserve and Federal Home Loan Banks. *Hearings on S. 406, supra* note 2, at 9 (statement of Senator Proxmire).

60. Wisniewski, *supra* note 38, at 383-407; Dennis, *The Community Reinvestment Act of*

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*B. The Regulatory Framework and Criteria*

The sparse provisions of the C.R.A. have been supplemented, during the ten years since enactment, by a series of regulations, examination procedures, and policy statements issued by the federal financial supervisory agencies. Additional guidance is provided by published rulings on specific requests for regulatory approval of branch offices and other changes.

The basic regulatory framework was jointly developed by the four agencies.<sup>61</sup> In so doing, these agencies were seeking to promote uniformity and to minimize the possibility that depository institutions might modify their charters in such a way as to transfer to the jurisdiction of an agency perceived as having a more permissive policy on C.R.A. enforcement.<sup>62</sup> The four agencies promulgated regulations<sup>63</sup> and examination procedures<sup>64</sup> that are identical except for minor technical and procedural variations.<sup>65</sup>

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1977: *Defining "Convenience and Needs of the Community,"* 95 BANKING L.J. 693, 700 (1978). See also Note, *The Community Reinvestment Act Regulations: Another Attempt to Control Redlining*, 28 CATH. U.L. REV. 635 (1979).

61. See *supra* text accompanying notes 13-16.

62. Comptroller of the Currency Robert Bloom, for example, noted that: "any agency taking a significantly stronger approach to CRA issues in handling applications for structure changes, would run a serious risk of losing banks through conversions. And of course, bank regulators, just as Mr. Dooley's Supreme Court, 'follow the election returns.'" R. BRANDEL & M. LARGE, *supra* note 29, at 23 (citing AMERICAN BANKER, Aug. 14, 1978, at 26). A similar dynamic applies to bank regulation by states. In New York, for example, a large number of banks converted from state charters to federal charters to take advantage of more liberal federal regulatory provisions. The state responded by liberalizing its own rules. Note, *supra* note 22, at 136-37 (citing N.Y., TEMP. ST. COMM'N ON BANKING, INS., & FIN. SERVS., REPORT OF THE COMMISSION 20-23, 70-73 (1984)). New York's own provision regarding community credit needs operates by making the federal C.R.A. (both the legislation and the regulatory rules) applicable to state-chartered banking institutions, thereby avoiding the possibility of differences in standards. *Id.* at 131, 144; N.Y. BANKING LAW § 28-b(3) (McKinney Supp. 1986); N.Y. ADMIN. CODE tit. 3, § 76-3 (1984).

63. 12 C.F.R. §§ 25.1-.8, 28.101 (1986) (Comptroller); 12 C.F.R. §§ 228.1-.8, .100 (1986) (Federal Reserve); 12 C.F.R. §§ 345.1-.8, .101 (1986) (F.D.I.C.); 12 C.F.R. §§ 563.3-.8 (1986) (F.H.L.B.B.). The regulations have remained virtually unchanged since their effective date in November 1978. CON. ADV. COUN., THE FEDERAL RESERVE'S IMPLEMENTATION OF THE COMMUNITY REINVESTMENT ACT OF 1977 I.1 (Bd. Gov. Fed. Res. Sys. Aug. 1983) [hereinafter cited as CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A.]. For a description of the process of drafting the regulations, see *id.*, Appendix C, *The Evolution of Regulations for C.R.A.* The only significant modification of the regulations was a special provision for banks that predominantly serve military personnel. 44 Fed. Reg. 18,163 (1979).

64. Uniform Community Reinvestment Act Examination Procedures were approved in 1980 by the Federal Financial Institution Examination Council, an organization of the four agencies. See, e.g., FEDERAL RESERVE SYSTEM COMPLIANCE HANDBOOK II.1.38-54. This is the first time the agencies have combined to create uniform procedures. *Id.* at II.1.38.

65. 43 Fed. Reg. 47,144 (Oct. 12, 1978). Because the four sets of regulations are substantively identical, future citations will refer to only one set, that of the F.H.L.B.B.

The record-keeping and mechanical requirements of the regulations are quite limited and not significantly burdensome.<sup>66</sup> Each regulated institution must (1) delineate its communities,<sup>67</sup> (2) adopt a "Community Reinvestment Statement" (hereinafter C.R.A. Statement),<sup>68</sup> (3) maintain a file of public comments available for inspection by any member of the public,<sup>69</sup> and (4) post a notice in its lobby.<sup>70</sup> Although not particularly time-consuming or expensive to prepare, these documents are critical in defining and monitoring the institution's performance.

The delineation of communities is of key importance because it defines the areas within which the institution will be held accountable for providing satisfactory and nondiscriminatory credit services. Earlier proposals would have established a statutory formula for the delineation, or would have delegated the function to the regulatory agencies.<sup>71</sup> The actual regulations leave the decision to the regulated institutions, subject to review by the supervisory agency.<sup>72</sup> An institution may be tempted to delineate its community in a manner that is inordinately narrow or gerrymandered to exclude neighborhoods the bank considers undesirable. Alternatively, an institution might designate an area that is so large that it unreasonably dilutes the effect which the institution may have on any more discrete neighborhood within the area.<sup>73</sup> Attention to the needs of "low- and mod-

66. The Director of the Federal Reserve System's Division of Consumer and Community Affairs stated that "CRA does not involve burdensome operational regulations." Garwood, *Regulatory Reform and Consumer Financial Services*, 38 BUS. LAW. 1295, 1308 (1983).

67. 12 C.F.R. § 563e.3 (1986).

68. 12 C.F.R. § 563e.4 (1986). The Statement contains a map of the community, and a list of the types of credit the institution proposes to make available. The regulation's requirements may be satisfied in the space of a brochure printed on both sides of a single page. See, e.g., The Dime Savings Bank of New York, Community Reinvestment Statement—New York City and Long Island Area (July 1, 1980).

69. 12 C.F.R. § 563e.5 (1986).

70. 12 C.F.R. § 563e.6 (1986). The prescribed language of the notice states that the public has a right to obtain a copy of the Community Reinvestment Statement, inspect the files, and complain to the institution and its regulator.

71. The Senate Committee's version of the bill which became C.R.A. defined a "primary savings service area." S. 1523, 95th Cong., 1st Sess. § 404 (1977). The agencies argued for administrative flexibility. *Hearings on S. 406*, *supra* note 2, at 13.

72. 12 C.F.R. § 563e.3(a), (b)(3) (1986). Depository institutions are cautioned against arbitrarily excluding low and moderate-income neighborhoods from their delineations. 12 C.F.R. § 563.3(a) (1986). See also the agencies' uniform C.R.A. Examination Procedures, in FEDERAL RESERVE SYSTEM COMPLIANCE MANUAL II.1.43-45 (1983). In practice, the supervisory agencies appear to prefer "nice circles" emanating from the deposit-taking facility. W. DENNIS & J. POTTINGER, *supra* note 5, at 10-3.

73. Figures from a 1976 study of redlining by four Bronx thrift institutions are illustrative. If their community was defined as the Bronx, the lending record of the four institutions would

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erate-income neighborhoods" is clearly at the heart of C.R.A.'s expectations, even though the Act also refers to the "entire community."<sup>74</sup> Designation of the community, therefore, is a primary focus of the agencies' review and of community groups' protests.<sup>75</sup>

The C.R.A. Statement specifies types of credit to be offered, and may also describe the overall program to ascertain and help meet credit needs.<sup>76</sup> Institutions are accountable, first, for developing a reasonable plan and, second, for providing those services equitably to all segments of the community, including the low- and moderate-income neighborhoods.

To assess the record of performance of a particular institution, the agencies established twelve criteria<sup>77</sup> phrased in rather general terms. The twelve criteria include the institution's program to communicate with members of the community and market its credit services; the institution's extension of credit for housing, small business, and small farms; the geographic distribution of credit applications and

be relatively poor: only 10, 18, 19, and 28 percent, respectively, of their loans were made in their (Bronx) community. If the community was defined as the New York metropolitan area (five boroughs and three nearby counties), however, their lending record was exemplary: 95, 88, 99, and 88 percent, respectively, of their loans went to the (metropolitan New York) community. McCluskey, *supra* note 31, at 43.

74. W. DENNIS & J. POTTINGER, *supra* note 5, at 9-19. The legislative history of C.R.A. leaves no doubt that the Act was intended to improve the availability of real estate credit in areas in which institutional lenders were historically reluctant to lend, which were usually low- and moderate-income neighborhoods. *See id.* at 9-14 to 9-20. The statute's language is, "the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods . . ." 12 U.S.C. § 2903(1) (1982).

75. *Community Reinvestment Act Examination Procedure*, in FEDERAL RESERVE SYSTEM COMPLIANCE HANDBOOK II.1.43-47 (1983); W. DENNIS & J. POTTINGER, *supra* note 5, at 9-69.

76. 12 C.F.R. § 563e.4 (1986).

77. C.R.A. Regulations, 43 Fed. Reg. 47,146-55 (Oct. 12, 1978). The twelve criteria (paraphrased and summarized) are as follows:

(a) Communication with members of the community, and other activities to ascertain credit needs.

(b) Marketing and other efforts to make the availability of credit services known in the community.

(c) Participation by the institution's board of directors in C.R.A. policy and performance.

(d) Any practices to discourage credit applications (prescreening).

(e) The geographic distribution of credit applications, extensions, and denials.

(f) Any discriminatory or other illegal practices.

(g) The record of opening, closing, and providing services at offices.

(h) Participation in community development projects.

(i) Extension of credit for housing, small business, and small farms.

(j) Participation in government loan programs for housing, small business, and small farms.

(k) Ability to meet credit needs, based on condition of the institution, the economy, and other factors.

(l) Other relevant factors. *Id.* at 47,148, § 25.7. Many of the factors overlap, reflecting either their generality or the fact that the list was drafted by a committee (with members representing the four agencies).

approvals; and the extent of participation by the institution's board of directors in C.R.A. policy and performance. Another factor is the institution's financial condition, thereby reserving the possibility that poor performance in serving credit needs will not be penalized if the institution is financially unable to perform better. Conspicuously absent is a system of weighting, or any indication of the relative importance of the different criteria.<sup>78</sup>

Lenders are encouraged to participate in the many programs that are directed towards assisting low- and moderate-income neighborhoods while minimizing lenders' risk.<sup>79</sup> Examples include Neighborhood Housing Services,<sup>80</sup> Federal Housing Administration Insurance,<sup>81</sup> Community Development Block Grants, Urban Development Action Grants, and the section 8 Housing System Program.<sup>82</sup> To increase the flow of mortgage investment capital, the secondary mortgage market agencies such as Fannie Mae and Ginnie Mae are very important.<sup>83</sup> Programs of the Small Business Administration, the

78. The omission of ranking or weighting of the twelve criteria was deliberate. Community Reinvestment Act of 1977; Implementation: Supplementary Information, 43 Fed. Reg. 47,144-45 (1977).

79. Summaries of such programs are contained in, e.g., Tisdale, F.H.L.B.B. Off. of Community Inv., *Programs Which May Help Meet Community Credit Needs* (undated), in *DISCRIMINATION IN MORTGAGE CREDIT: REGULATION, LITIGATION, AND COMPLIANCE* 271 (W. Dennis & D. Glascoff, Jr., eds., Prac. L. Inst. 1979); *COMP. OF THE CURR., PROGRAM GUIDEBOOK TO HELP MEET COMMUNITY CREDIT NEEDS: A GUIDEBOOK FOR BANKS AND BANK EXAMINERS* (1979).

80. Neighborhood Housing Services was originated by F.H.L.B.B., with subsequent participation by the other three supervisory agencies. The program's purpose was to coordinate concentrated cooperative efforts of several lending institutions, municipal officials, and community groups to improve target areas. The program has demonstrated considerable success, while minimizing the risk incurred by any individual participating lending institution. Duncan, Hood & Neet, *supra* note 20, at 534-39; Ryan, *Redlining*, ANN. SURV. AM. L. 57, 75-83 (1977); Statement by Nancy H. Teeters, Member, Board of Governors of the Federal Reserve System, before the Subcommittee on Domestic Monetary Policy of the House Committee on Banking, Finance, and Urban Affairs, May 29, 1980, 66 Fed. Res. Bull. 471 (1980).

81. By relieving the lending institution of risk of loan default, F.H.A. insurance appears to offer an ideal solution for depository institutions under pressure to lend in neighborhoods they consider risky. However, because F.H.A. loans may also have negative effects on neighborhoods, see *supra* note 21, the lender must be careful to avoid practices that would violate the Equal Credit Opportunity Act and C.R.A. An example would be granting conventional loans only in white or upper-income neighborhoods, and granting government-insured loans only in black or lower-income areas. Dennis, *The Dual Housing Credit Market*, *supra* note 19, at 314-15.

82. These programs of the Department of Housing and Urban Development are described in, e.g., F.H.L.B.B. OFF. OF COMMUNITY INV., *LEVERAGING* (undated) (copies on file at *Pacific Law Journal*).

83. The Federal National Mortgage Association ("Fannie Mae"), Government National Mortgage Association ("Ginnie Mae"), and Federal Home Loan Mortgage Corporation ("Freddie Mac") purchase mortgage loans from the originating financial institutions, using funds raised by selling securities to the public. For descriptions of the relation of these programs to C.R.A. see, e.g., F.H.L.B.B. OFF. OF COMMUNITY INV., *THE SECONDARY MORTGAGE MARKET* (undated); R. STARR, *HOUSING AND THE MONEY MARKET* 188-93 (1975).



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Farmers Home Administration, and state and local governments offer further possibilities for promoting C.R.A.'s purposes.

The agencies went to substantial lengths to reassure lenders that mandatory credit allocation was not intended. The examination procedures state there are no "hard and fast rules or ratios."<sup>84</sup> The Act does not "require financial institutions to make high risk loans that jeopardize their safety."<sup>85</sup> Examiners were admonished not to insist upon any specific action, such as making a certain type of loan, or to unduly burden an institution.<sup>86</sup> The degree of flexibility is so great that one commentator has wondered "whether it is a game of regulatory hide and seek, or regulation by telepathy."<sup>87</sup>

On completing a compliance review, an examiner prepares a narrative statement, discussing each of the criteria, offering suggestions for improvement, and reporting violations.<sup>88</sup> In addition, the examiner assigns a numerical rating, which is not disclosed to the institution (at least not formally),<sup>89</sup> ranging from one, representing the best record, to five, representing the worst.<sup>90</sup> This scale parallels and supplements the one to five system used for examinations based on financial "safety and soundness" factors.

When a depository institution applies for approval of a new office, the supervisory agency considers C.R.A. factors as an aspect of the "convenience and needs" formula. An application may be approved despite an extremely unfavorable rating on C.R.A. compliance, due to other considerations based on safety and soundness, and on competition among financial institutions.<sup>91</sup>

### C. Data Collection and Analysis

Assessment of an institutional lender's record involves a considerable quantity of data, both internal and external to the subject

84. *Community Reinvestment Act Examination Procedures*, in FEDERAL RESERVE SYSTEM COMPLIANCE HANDBOOK II.1.39.

85. *Id.*

86. *Id.* at II.1.41.

87. W. DENNIS & J. POTTINGER, *supra* note 5, at 9-12.

88. *Community Reinvestment Act Examination Procedures*, in FEDERAL RESERVE SYSTEM COMPLIANCE HANDBOOK II.1.54.

89. *Id.* Although C.R.A. ratings are not officially disclosed to depository institutions, informal comments by agency staff probably allow an institution to make a fairly accurate guess.

90. *Uniform Interagency Community Reinvestment Act (CRA) Assessment Rating System*, in FEDERAL RESERVE SYSTEM COMPLIANCE HANDBOOK II.1.55-65.

91. Legislative history supports this interpretation. See, e.g., 123 CONG. REC. S1202-03 (daily ed. Jan. 24, 1977); *Hearings on S. 406*, *supra* note 2.



institution's documents, plus substantial effort and analytic skill. An important starting point is the information made available pursuant to the Home Mortgage Disclosure Act of 1977 (H.M.D.A.), which is applicable to lenders located in metropolitan areas.<sup>92</sup>

H.M.D.A. reports disclose the number and total amount of real estate loans, itemized by census tract. Detail is provided on borrowers' income level and racial characteristics, participation in federal mortgage insurance programs, loans to borrowers not residing on the property, and home improvement loans.<sup>93</sup> H.M.D.A. data therefore permits an overview of the geographic and racial distribution of an institution's loans. It may be extremely useful in identifying patterns or raising issues for further investigation.

Data on demand for credit, however, is not included in H.M.D.A. reports. A lender should not be faulted for low absolute levels of lending activity in certain neighborhoods if the causes are beyond the lender's control, such as a low level of demand for credit in that neighborhood. The most obvious means of measuring demand is review of the loan applications received, with the purpose of determining whether there is a pattern of rejection correlated with the race of the applicant or the geographic location of the proposed collateral. The limitation of this approach is that applications may have been "pre-screened" (in violation of Equal Credit Opportunity regulations). Bank personnel might verbally discourage blacks from submitting loan applications, and thereby avoid a written record of rejections.

Even if its current practices are acceptable, an institution may have developed a reputation which discourages certain classes of potential borrowers from applying for loans. Some banks, for example, strive to create a public image as banks catering to high-income individuals and businesses, not as banks seeking or willing to lend in an inner-city neighborhood.<sup>94</sup> In some instances, banks actively solicit deposits

92. 12 U.S.C. §§ 2801-2809 (1982).

93. 12 U.S.C. § 2803 (1982). More specific requirements are stated in Regulation C, promulgated by the Federal Reserve Board and enforced by all four agencies plus the National Credit Union Administration. 12 C.F.R. § 203 (1982).

The supervisory agencies are compiling the information from individual institutions into statistical tables for metropolitan areas. A 1980 amendment to H.M.D.A. requires the Federal Financial Institutions Examination Council (composed of the four agencies) to prepare tables annually for each standard metropolitan statistical area, indicating lending patterns of depository institutions for various categories of census tracts, grouped according to location, age of housing, income level, and racial characteristics. Housing and Community Development Act of 1980, Pub. L. No. 96-399, Sec. 340, § 304(f), 94 Stat. 1658 (1980).

94. See, e.g., *In re: Dauphin Deposit Bank & Trust Co.*, Harrisburg, Dauphin County,

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from lower and middle-income neighborhoods, but consistently omit mention of credit services from advertising directed at those neighborhoods.<sup>95</sup> Those same banks may actively promote mortgage lending in higher-income neighborhoods (especially suburbs), through such means as advertising, contacts with local real estate agents, and mailings to depositors. The result is that "demand," as measured by credit applications, appears to be present overwhelmingly in the higher-income neighborhoods. As a result, the regulations and the demands of community groups place important emphasis on making the availability of credit known through advertising and other marketing efforts to low- and moderate-income neighborhoods.<sup>96</sup>

Precise measurement of credit demand that has not been expressed in loan applications is probably impossible. Nevertheless, a number of means are available to counter or discredit contentions sometimes raised by lending institutions that lack of demand accounts for low lending activity in particular neighborhoods.<sup>97</sup> Using sophisticated statistical methods, data on loan patterns may be adjusted to account for population density factors in demand. The number of applications

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Pa., Application for Consent to Establish a Branch (Denial) (F.D.I.C. June 23, 1980) [hereinafter cited as F.D.I.C. Order in *re Dauphin* (Denial)]; Application to Merge First Nat'l Bank of Clermont County, Bethel, Ohio, into Soc'y Nat'l Bank of Cleveland, Cleveland, Ohio, Under the Charter of Soc'y Nat'l Bank of Cleveland, and with the Title of "Soc'y Nat'l Bank," at Supplement 2 (Compt. Curr. Mar. 21, 1980); Letter from John F. Downey, Regional Administrator of National Banks, to Daniel J. Callahan, President, The Riggs National Bank of Washington, D.C. (Apr. 23, 1981) (perception of Riggs as a "rich man's bank"). Decision of the Comptroller of the Currency on the Applications of Dimension Financial Corp. to Charter 31 National Banks in 25 States (May 9, 1984), cited in Lobell, *Distribution of Consumer Financial Services—Nonbank Banks and Regional Interstate Banking Zones*, 40 BUS. LAW. 1075, 1087 (1985) (bank planned to "focus marketing efforts on upwardly mobile individuals"; but application was nevertheless approved). In one case, a New York bank sent Bronx residents a "Get Moving Kit" emphasizing the availability of residential mortgage credit in suburban counties. Citicorp, 68 Fed. Res. Bull. 499, 501 (1982); Statement of Roger Hayes, New York City Coalition Against Redlining, in *Community Reinvestment Act Compliance: New York City Banks, Hearing Before A Subcomm. of the Comm. on Gov't Operations, House of Representatives*, 97th Cong. 2d Sess. 2, 5 (1982) [hereinafter cited as *Hearing on C.R.A. Compliance*].

95. See, e.g., Community Reinvestment Act (CRA) Supplement to the Decision of the Comptroller of the Currency to Approve the Branch Applications submitted by Mich. Nat'l Bank of Detroit, Detroit Mich. (Compt. Curr. Apr. 24, 1980).

96. See, e.g., 43 Fed. Reg. 47,144-55 (Oct. 12 1978); *Information Statement Re Community Reinvestment Act*, 66 Fed. Res. Bull. 30, 31 (1980).

97. Greater New York Savings Bank, for example, argued that the reason that only 6.5% of real estate investments were in Brooklyn, even though 80% of its deposits were derived there, was lack of demand. In response, a protesting community group submitted affidavits of Brooklyn residents who had been denied credit or discouraged from applying, and they also submitted data indicating that 50% of all single-family housing transactions in Brooklyn were financed with seller mortgages, presumably because institutional loans were perceived as being unavailable. W. DENNIS & J. POTTINGER, *supra* note 5, at 10-43.

or of approved loans is then stated per capita or per housing unit in different areas.<sup>98</sup> The loan portfolios of competing depository institutions and mortgage bankers, and Housing and Urban Development (H.U.D.) records of loans insured by the Federal Housing Administration (F.H.A.) may also be used to demonstrate that other lenders are finding demand. One technique accepted by the agencies that provides a rough measure of unsatisfied demand is analysis of municipal real estate registers,<sup>99</sup> which document each title transfer and indicate whether a mortgage was taken by an institutional lender or by some other party.<sup>100</sup> Underlying this analysis is the presumption that transactions will generally be financed by sellers only if credit from institutional sources is perceived to be unavailable.

Statistical analysis can also disclose racially discriminatory effects of lending policies. Studies using census data on race, income level, and other characteristics have compared lending levels in different neighborhoods that have the same income level within a single city. These studies repeatedly determined that as the percentage of blacks in a neighborhood increases, the percentage of transactions financed by conventional mortgages decreases.<sup>101</sup> The supervisory agencies have acknowledged the existence of disparities in lending activity by neighborhood which—contrary to the repeated assertions of lenders—cannot be accounted for by factors affecting demand for mortgage credit.<sup>102</sup>

Statistical evidence of disproportionately low levels of lending in particular neighborhoods is rebuttable by evidence that a depository institution has attempted in good faith to improve its lending record. Efforts to, for example, increase lending in low- and moderate-income neighborhoods are favorably considered even if they do not result in early tangible success.<sup>103</sup>

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98. Canner & Cleaver, *The Community Reinvestment Act: A Progress Report*, 66 Fed. Res. Bull. 87, 90 (1980) (stating that Federal Reserve staff has at times used a ratio of mortgage loans to total transfers); National City Corp., 67 Fed. Res. Bull. 545 (1981) (using number of deed transfers as a "proxy" for demand).

99. Descriptions of related techniques, and examples of their usage are contained in *ASSESSING COMMUNITY CREDIT NEEDS: A CRA GUIDEBOOK* 15-27 (U.S. Dept. Hous. & Urb. Dev. Oct. 1980).

100. See, e.g., National City Corp., 67 Fed. Res. Bull. 52 (1981).

101. NAT'L TRAIN. & INFO. CTR., *A GUIDEBOOK: HOME MORTGAGE DISCLOSURE ACT AND REINVESTMENT STRATEGIES* (Off. Pol'y Dev. & Res., U.S. Dept. Hous. & Urb. Dev. 1979) [hereinafter cited as N.T.I.C., *GUIDEBOOK*] (discussing studies in Philadelphia, Baltimore, and several other cities).

102. *Information Statement Re Community Reinvestment Act*, 66 Fed. Res. Bull. 30, 31 (1980).

103. The process has been described as an inverse relationship between "bottom line" and

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Application of the Act, regulations and examination procedures thus entails consideration of a broad range of factors and large quantities of data. The sophistication and thoroughness of the parties accumulating and analyzing data may become as important as the standards themselves.

### III. COMMUNITY GROUPS: THE ACT'S BENEFICIARIES AND DRIVING FORCE

The effect of C.R.A. in practice (though not in official federal policy) depends primarily on the energy, activism, and sophistication of community groups. Community activism affects both the conduct of a depository institution and the degree of attention focused on that lender by the supervisory agency. It can be no mere coincidence that of all of the dozens of formal rulings issued by the supervisory agencies which focus particular attention on C.R.A. issues, virtually all involve challenges brought by community groups.<sup>104</sup> It appears

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"process." As the actual lending performance becomes more impressive, an institution will be under less pressure to demonstrate that its efforts, procedures and internal controls are consistent with C.R.A., and vice versa. W. DENNIS & J. POTTINGER, *supra* note 5, at 9-13 to 9-14.

104. All except four of the agencies' formal rulings mention a community group's challenge in the text of the opinion. The exceptions are: Application of Marine Midland Bank, Buffalo, N.Y., to Convert from a Banking Inst. Chartered Under the N.Y. Banking Law to a Nat'l Banking Ass'n (Comp. Curr. Jan. 28, 1980). *In re*: Provident Savs. Bank, Jersey City, Hudson County, N.J., Application for Consent to Establish a Branch (Denial), Statement (F.D.I.C. Sept. 29, 1980); *In re*: Citizens Bank & Trust Co. of Md., Riverdale, Prince Georges County, Md., Application for Consent to Establish a Branch (F.D.I.C. Feb. 9, 1981) (plus a second Order on another application of the same bank decided on the same day); Hutsonville Bank Corp., 67 Fed. Res. Bull. 48 (Fed. Res. Bd. 1981) (not listing the name of a protestant but noting that "all comments received" were considered). One other ruling followed a challenge filed not by a community group but by a competing bank. First Nat'l Boston Corp., 66 Fed. Res. Bull. 162 (Fed. Res. Bd. 1980). See also W. DENNIS & J. POTTINGER, *supra* note 5, at 9-21 ("Agencies take 'tougher' positions when a protest has been filed then when an application is unopposed. Thus, a lending practice which may be unchallenged in most circumstances becomes the subject of official criticism when a protest is involved.")

Geographically, community group protests on C.R.A. grounds are concentrated in the northeastern seaboard, the midwest, and California. According to a study for the Federal Reserve Board, the 28 C.R.A. protests it received between the Act's effective date in November 1978 to December 1982 were distributed among the Federal Reserve's twelve Districts as follows:

|                |                 |
|----------------|-----------------|
| 4 Boston       | 4 Chicago       |
| 4 New York     | 3 St. Louis     |
| 4 Philadelphia | 0 Minneapolis   |
| 7 Cleveland    | 0 Kansas City   |
| 0 Richmond     | 0 Dallas        |
| 1 Atlanta      | 1 San Francisco |

likely that a similar pattern exists in cases that do not reach the stage of a formal decision.<sup>105</sup>

#### A. Relations with Depository Institutions

Beyond any doubt, one of the effects of the Act has been to enhance the bargaining position of community groups involved in redlining issues.<sup>106</sup> "Arrogance" is the term that community groups repeatedly use to describe the attitudes of some lending institutions prior to the enactment of C.R.A. or prior to filing objections under C.R.A.<sup>107</sup> (Bankers, perhaps not accustomed to discussing investment policy with picketing groups of blue-collar workers<sup>108</sup> might well

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CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63, Table F6.3. A different study, focusing on protests received by F.D.I.C., Federal Reserve Board (F.R.B.), and O.C.C. between enactment of C.R.A. in 1977 and September 1981, concluded that most protests were filed in "the 'old' industrial sectors of the country." Melvin, *The First Thousand Days of the Community Reinvestment Act*, J. COM. BANK LENDING 53-54 (July 1982). The states from which the largest numbers of protests originated, according to this study, are as follows:

|                  |                     |
|------------------|---------------------|
| 19 New York      | 5 Illinois          |
| 11 Pennsylvania  | 5 Michigan          |
| 10 Massachusetts | 5 Wisconsin         |
| 10 Ohio          | 30 All other states |

*Id.* at 54.

105. Community groups operate on the premise that "the regulators themselves are often ex-bankers which their sympathies can reflect. Hence except in some rare cases, it usually takes some prodding from individuals or groups to get the wheels of examination and regulation rolling." V. BENEDEK, *supra* note 37, at 7. See also TRI-STATE GREENLINING, *supra* note 21, at 8 ("the effectiveness of the Act will be largely determined by the extent of citizen participation in the regulatory process"). One commentator has concluded that prodigious and persistent efforts by community groups are the reason that C.R.A. and H.M.D.A. have been enforced at all. Comment, *Redlining, Disinvestment, and the Role of Mutual Savings Banks: A Survey of Solutions*, 9 FORDHAM URB. L.J. 89 (1980).

106. Community groups and supervisory agencies appear to agree that C.R.A. has provided important new power to community groups. For statements by community groups, see, e.g., Statement of Roger Hayes, New York City Coalition Against Redlining, in *Hearings on C.R.A. Compliance*, *supra* note 94, at 2; N.T.I.C., GUIDEBOOK, *supra* note 101, at 55. The regulatory agencies recognize that lending institutions often negotiate settlements with community groups to avoid delays and possible denials of application filed by the lenders with the agencies. See, e.g., Canner, *Redlining: Research and Federal Legislative Response*, 68 Fed. Res. Bull. 610 (1982).

107. For numerous accounts of banks refusing to negotiate and the reactions of community groups, see V. BENEDEK, *supra* note 37; N.Y. PUB. INT. RES. GROUP, TAKE THE MONEY AND RUN: REDLINING IN BROOKLYN, TWO YEARS LATER (1979) [hereinafter referred to as N.Y.P.I.R.G., TAKE THE MONEY] (copies on file at the *Pacific Law Journal*); Healey, *supra* note 58, at 735-36.

108. The backgrounds and attitudes of members of several groups are described, by or from the perspective of their leaders, in V. BENEDEK, *supra* note 37. The principal occupations listed are work in steel mills, construction, trades, railroad yards, cafeterias, and the post office, short-order cook, housewife, and domestic. *Id.* at 25, 28, 40, 64. Class differences with



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characterize the protesters' attitudes in a similar manner.) Requests to meet with the management of an institution to discuss redlining issues were frequently met with flat refusal or intransigence, according to accounts written by community organizations. Vocal public demonstrations and campaigns to withdraw deposits were a common reaction by the groups.<sup>109</sup>

C.R.A. has tended to bring the community groups off the streets and into the conference rooms of lending institutions and supervisory agencies. Groups have found that filing a challenge to an institution's application for a branch or a merger produces marked improvements in negotiating posture, in some instances causing banks to consider their proposals seriously for the first time.<sup>110</sup>

Depository institutions are most susceptible to pressure when an application is pending before a supervisory agency. Even when no application is pending, however, banks are virtually required to be responsive to community groups' requests to discuss credit policy, and even to affirmatively seek contact with the organizations in order to assess community credit needs.<sup>111</sup> Bankers who fail to develop

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bankers—described as living in suburbs and not having knowledge or concern for the institutions' urban neighborhoods—are frequently voiced, and many activists take pride in accomplishing substantial changes in bank policy without previous background in banking. *Id. passim*.

109. V. BENEDEK, *supra* note 37; N.Y.P.I.R.G., TAKE THE MONEY, *supra* note 107. According to one group in Brooklyn, the president of one savings bank initially stated that Brooklyn has "gone down the tubes" and would receive no loans from his bank, and the president of a savings and loan association said that "Jesus Christ himself could not get a loan in Brooklyn." After picketing, deposit withdrawal campaigns, lengthy negotiations, and public hearings, those two associations and six others signed agreements with the protesters. *Id.*

110. One recent example was an agreement by United Virginia Bank to make \$10 million in loans to low-income neighborhoods. According to Allen J. Fishbein, of the Center for Community Change, "it was only when the bank had an appeal pending (for the acquisition [of another bank]) that we had real leverage." Ansberry, *Banks with Interstate Ambitions are Challenged by Law Requiring Commitment to Local Lending*, Wall St. J., June 26, 1986, at 58, cols. 1-5 (citing additional examples). The same result was reported, for example, by groups challenging the Society National Bank in Cleveland, V. BENEDEK, *supra* note 37, at 46-47; Northside Savings Bank in New York City, *id.* at 67; Shelby Federal Savings and Loan Association in Indianapolis, *id.* at 72. See also W. DENNIS & J. POTTINGER, *supra* note 5, at 10-4 (stating that community groups use protests as "levers" to bring the lender to the bargaining table). A newspaper account provides an interesting perspective on a major Chicago bank's program to extend \$100 million in loans, below market interest rates, in lower and middle-income neighborhoods, and to make direct grants of as much as \$400,000 to "neighborhood development concerns." The bank had never previously been sympathetic to complaints that it did little banking in the city's disadvantaged areas, according to a leader of community groups, and announced its program only after the groups threatened to protest the bank's application to the Federal Reserve Board for approval of a \$275 million acquisition of another bank. *First Chicago Forms Program for Lending in City Neighborhoods*, Wall St. J., Mar. 7, 1984, at 4, col. 4.

111. 12 C.F.R. § 563e.7, assessment factor (a); C.R.A. Examination Procedures § 8(a).



good relations with community groups risk unfavorable ratings by regulators, and, perhaps more importantly, challenges to future applications. These challenges can impose substantial costs, even if ultimately unsuccessful.

For a group to be effective, it must develop expertise, devote considerable energies to documentation, and show persistence in negotiations. Supervisory agencies accord little weight to complaints or assertions that are not supported by statistical or other data,<sup>112</sup> and they expect or encourage community groups to attempt to resolve their differences with depository institutions by negotiation.<sup>113</sup>

In many cases, the level of sophistication of community groups has been impressive. Multivariate regression analysis has been applied to evaluate the geographic dispersion of loans, using H.M.D.A., deed transfer, and census data.<sup>114</sup> Information may also be obtained through 8-K and 10-K reports filed with the Securities and Exchange Commission by bank holding companies, statistics on deposits issued by the supervisory agencies, annual reports to shareholders, "statements of condition" to regulators, and local real estate transaction registers.<sup>115</sup>

Although confrontation remains a strategy in redlining disputes, many groups have come to recognize the importance of flexibility

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The pragmatic importance of good community relations, and means for promoting it, is discussed in detail in W. DENNIS & J. POTTINGER, *supra* note 5, at 11-35.

112. Under F.H.L.B.B. standards, for example, a protest is not deemed "substantial," thereby entitling the protestant to a hearing, unless it is in writing, timely, and contains "specific objections supported by reasons and facts including economic or financial data." 12 C.F.R. § 542.2(e)(4) (1986). A joint statement indicated that agency staff will investigate the merits of the application and protest, but also said that "The agencies expect the protestants to provide evidence to support their complaints to the extent possible. For example, information on deed transfers may indicate mortgage loan demand . . . ." Fed. Fin. Insts. Exam. Coun., Community Reinvestment Act Information Statement (Sept. 12, 1980), 45 Fed. Reg. 63,134 (1980).

113. Fed. Fin. Inst. Exam. Coun., Community Reinvestment Act Information Statement (Sept. 12, 1980), 45 Fed. Reg. 63,133-34 (1980).

114. National City Corp., 68 Fed. Res. Bull. 427, 429 n.6 (1982). A computer program for tabulating and analyzing H.M.D.A. data by zip code or census tract for neighborhood comparisons is offered by the National Training and Information Center, which also provides training sessions and technical assistance to local community groups engaged in C.R.A. activities. N.T.I.C., *GUIDEBOOK*, *supra* note 101.

115. For guides to data collection and analysis, published by community action organizations, see, e.g., R. GOLDEN & J. ROSENBERG, *supra* note 44; NAT'L TRAIN. & INFO. CTR., *PASS THE BUCK . . . BACK: THE C.R.A. HANDBOOK* (1979); N.T.I.C., *GUIDEBOOK*, *supra* note 101. In addition, H.U.D.'s Office of Neighborhoods, Voluntary Associations, and Consumer Protection publishes documents including: H.M.D.A. AND REINVESTMENT STRATEGIES—A *GUIDEBOOK* (1980); USING H.M.D.A. DATA FOR COMMUNITY DEVELOPMENT AND MAINTENANCE—A *GUIDEBOOK* (1980); ASSESSING COMMUNITY CREDIT NEEDS: A C.R.A. *GUIDEBOOK* (U.S. Dept. Hous. & Urb. Dev. 1979).

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and negotiation with banks, so that mutually acceptable results can be reached.<sup>116</sup> Community groups sometimes withdraw their challenges or even take affirmative steps to recommend the approval of a lender's application to supervisory agencies.<sup>117</sup>

### B. Goals and Results

The demands made by community groups generally focus on increasing mortgage and home improvement lending within their neighborhoods.<sup>118</sup> Groups often demand commitments from lending institutions to provide real estate loans in a particular neighborhood in a prescribed amount or to accept a prescribed percentage of deposits drawn from that neighborhood.<sup>119</sup> This approach has been rejected by Congress and by the supervisory agencies, but nevertheless is occasionally successful. Some banks have agreed to provide specific types of loans on specific terms.<sup>120</sup> Also, community groups often

116. See, e.g., the accounts of several antiredlining campaigns in V. BENEDEK, *supra* note 37, at 23, 24, 100, *passim*. Interviews with both community group and supervisory agency staff members confirmed the point that the most common and successful strategy for community groups and banks is negotiation in private settings. Telephone conversation with Tom Schraw, National People's Action, Chicago, Illinois (July 3, 1985); telephone conversation with James W. Lowell, Community Affairs Coordinator, Division of Consumer and Community Affairs, F.R.B., Washington, D.C. (July 3, 1985). They agree also that the federal agencies sometimes facilitate or arrange such meetings, and that results should be publicly announced not as antiredlining agreements but rather as cooperative initiatives for community improvement. *Id.*

117. In several cases before the Board of Governors of the Federal Reserve System, for example, community groups reached negotiated settlements with banks, and withdrew their protests. Trust Co., 65 Fed. Res. Bull. 669 n.1 (1979); Landmark Bankshares Corp. (decided Nov. 30, 1979, per Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813 (1981), but not otherwise reported in the *Federal Reserve Bulletin*); Mid-Continent Bancshares, Inc. (decided Nov. 9, 1979, per Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813 (1981) but not otherwise reported in the *Federal Reserve Bulletin*); Girard Co., 67 Fed. Res. Bull. 916 (1981); First Nat'l Bank of Allentown (decided Aug. 28, 1981, per Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813 (1981), but not otherwise reported in the *Federal Reserve Bulletin*). Gaining community groups support of an application has been stated as a goal of bank public relations efforts. Healey, *supra* note 58, at 737.

118. The goals and results of many community group protests to C.R.A. applications are described in W. DENNIS & J. POTTINGER, *supra* note 5, at 10-7 to 10-16 (F.H.L.B.B.), 10-23 to 10-33 (F.R.B.), 10-37 to 10-39 (O.C.C.), 10-42 to 10-48 (F.D.I.C.).

119. G. CANNER, *THE COMMUNITY REINVESTMENT ACT AND CREDIT ALLOCATION* 3-4 (Staff Study 117, Bd. Govs. Fed. Res. Sys. 1982) [hereinafter cited as G. CANNER, *CREDIT ALLOCATION*].

120. See, e.g., Loan Policy Agreement between Perpetual Federal Savings and Loan Association, Washington, D.C., and several community groups, *reprinted in* NEIGHBORHOOD-BASED REINVESTMENT STRATEGIES: A CRA GUIDEBOOK, Appendix F. (U.S. Dept. Hous. & Urb. Dev. Oct. 1980). The lender agreed to offer conventional and F.H.A./V.A. loans on specific types of property, with specific terms and creditworthiness standards, and specific priorities during periods of limited funds. The community groups agreed to withdraw their protest with the F.H.L.B.B., and not undertake a depositor boycott or proxy challenge. In

focus on increasing advertising and other efforts to market credit services in their neighborhoods.

Additional concerns of community groups include obtaining financing for special projects, establishing procedures for review of rejected loan applications, and a variety of other goals which were perhaps not originally anticipated by Congress.<sup>121</sup> One central-city community group, for example, sought contributions from a bank to turn vacant lots into mini-parks, noting that the bank made large charitable contributions to the local orchestra and garden center.<sup>122</sup> Another group included in its C.R.A. protest charges of discrimination in employment practices.<sup>123</sup> A group of tenants obtained agreements from lenders to enforce clauses in existing mortgages requiring the mortgagors/landlords to maintain and repair their buildings. The lenders also agreed to lend additional amounts to the landlords if necessary, and to allow the tenants some input into lending decisions involving the determination of who their landlords would be.<sup>124</sup>

In summary, the C.R.A. has provided community groups important new power. They now have standing to formally participate in the process of regulatory examination of institutions, a significantly

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another instance a savings and loan association acquiesced to protestors' demands that it commit 10% of deposits to specific types of loans. F.H.L.B.B. Board members were uncomfortable with the quota, but chose not to interfere with the agreement. Community Federal Savings & Loan—St. Louis, Mo., Res. No. 79-204, discussed in W. DENNIS & J. POTTINGER, *supra* note 5, at 10-7 to 10-10. Another bank committed specific funds for real estate lending with a 1% reduction in interest rates in low- and moderate-income neighborhoods. *In re: Dauphin Deposit Bank & Trust Co., Harrisburg, Dauphin County, Pa., Reconsideration of an Application for Consent to Establish a Branch* (F.D.I.C. Dec. 8, 1980) [hereinafter cited as F.D.I.C. Order in *re: Dauphin* (reconsideration)]. Other examples are cited in G. CANNER, CREDIT ALLOCATION, *supra* note 119, at 7-8.

121. See, e.g., N.T.I.C., GUIDEBOOK, *supra* note 101, at 24; NEIGHBORHOOD-BASED REINVESTMENT STRATEGIES: A CRA GUIDEBOOK 42-58, 67-75 (U.S. Dept. Hous. & Urb. Dev. Oct. 1980) (describing the goals and results of several community group protests). See generally the issues discussed in the formal opinions issued by supervisory agencies, described *infra* at part V, of which almost all were prompted by community group action.

122. V. BENEDEK, *supra* note 37, at 44-45 (involving Society National Bank in Cleveland). The community group also was able to prove that the bank granted home improvement loans directly to homeowners in higher-income areas, but not in low- moderate-income areas. In the disfavored areas, the bank would only purchase homeowners' notes from a building contractor. The result was that the lower-income residents were forced (since they had no other financing available) to deal with a particular contractor whose work was said to be shoddy and overpriced. *Id.*; Society Nat'l Corp., 66 Fed. Res. Bull. 351 (Fed. Res. Bd. 1980). See also V. BENEDEK, *supra* note 37, at 96 (involving two San Diego thrift institutions).

123. National City Corp., Cleveland, Ohio, 67 Fed. Res. Bull. 52 (1981) (employment practices ruled to be outside of scope of C.R.A.).

124. N.T.I.C., GUIDEBOOK, *supra* note 101, at 91. See also V. BENEDEK, *supra* note 37, at 64.

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enhanced posture for negotiation with lending institutions, and opportunities to influence the policy of both lenders and regulators. In exercising these powers, some groups have shown considerable expertise, energy, and imagination.

### IV. THE EFFECT ON DEPOSITORY INSTITUTIONS

The responses of banks and savings and loan associations to C.R.A. have been varied. At minimum, C.R.A. has added a new element to institutions' relations with their regulators and with community groups. At maximum, C.R.A. has promoted major changes in lending policy.

#### A. Incentives to Comply

The single sanction readily apparent on the face of the C.R.A. is not, in practice, the direct cause for changes in lending policy. The Act provides that a depository institution's record in meeting community credit needs must be considered by the supervisory agencies before approving an application for a merger, acquisition, or office change.<sup>125</sup> After a decade of experience with administration of the Act, it is safe to say that poor C.R.A. performance will not result in denial of an application except in the most extreme, egregious cases, and perhaps not even then. The number of denials on C.R.A. grounds is miniscule and, for at least one of the supervisory agencies, zero.<sup>126</sup>

Other factors, however, cumulatively provide substantial incentives to depository institutions. Principal among those factors are delay in processing the application, adverse publicity, and embarrassment.

A protest by a community group to an application results in protracted investigation and hearings by the supervisory agencies.<sup>127</sup>

125. 12 U.S.C. 2903.

126. Statistics on applications denied by each of the agencies, and analysis of the instances involved, are contained in part V of this Article.

127. In the Federal Reserve System, for example, applications typically are decided in an average of 3.7 months, but protested applications take between 3 and 13 months, with the usual case lasting 6 months. The F.R.B. is concerned that community groups could "impose expensive delays on applicants in order to extricate agreements . . ." G. CANNER, *CREDIT ALLOCATION*, *supra* note 119, at 5, 5 n.22. Delay occurs even if the protest turns out to be groundless, because of the need for notification periods, and the increased agency scrutiny. See Note, *Commercial Bank Mergers: The Case for Procedural and Substantive Deregulation*, 95 HARV. L. REV. 1914, 1916-18, 1927 (1982) (noting that judicial review is rarely sought because the prospects of additional delay and major expense causes the parties to a merger to abandon the deal).

The delay in processing may cause arrangements for the planned acquisition of real estate to lapse, planned construction to be disrupted, or competition from other institutions to arise. At minimum, the lender will be denied, for a period, the business advantages contemplated, such as an increase in market share or deposits.

Publicity resulting from an investigation or from a community group protest can only have adverse effects on a bank or savings and loan association. Public relations and image are important to depository institutions.<sup>128</sup> Perhaps the most important, though unquantifiable, factor is the discomfort experienced by the management of depository institutions when accused of violating federal law and being derelict in their community responsibilities. In addition to stigma among social associates, management is compelled to explain to the board of directors of a depository institution why the application has not received timely processing, and why the institution's prestige and business opportunities are at risk.<sup>129</sup>

At one time, management could and did argue that fiduciary duty to the shareholders and depositors compelled a lending policy that was not concerned with impact on a particular neighborhood.<sup>130</sup> As a result of C.R.A., that argument is discredited, and the economic realities are reversed. Currently, failure to be concerned with impact on a particular neighborhood constitutes a breach of the responsibilities of management. The only available arguments, now, are that management has done enough in that direction.

The effect of criticism from regulatory agencies also should not be underestimated, despite the unlikelihood that the agencies will

128. As one illustration, fears of negative publicity caused a Tennessee bank to withdraw an application with the O.C.C. The bank's chief executive officer was concerned that denial of the application, caused by C.R.A. reasons, would be misinterpreted by the public, since the Comptroller does not announce his reasons. W. DENNIS & J. POTTINGER, *supra* note 5, at 10-40.

129. Derivative actions against management for loss of a valuable business opportunity through negligence are even a possibility. Healey, *supra* note 58, at 737 (citing remarks of Neal L. Peterson, General Counsel, Federal Reserve Board, reported in AM. BANKER, Jan. 26, 1979, at 6); W. DENNIS & J. POTTINGER, *supra* note 5, at 11-11.

130. See, e.g., Statement of Grover J. Hanson, Chairman, First Federal Savings and Loan Association of Chicago, in *Hearings on S. 1281 before Senate Comm. on Banking, Housing, and Urban Affairs*, 94th Cong., 1st Sess. 85 (1978), cited in Note, *Redlining: Should Local Government Become Involved?*, 10 U.C. DAVIS L. REV. 243, 249 (1977); Earthman, *Residential Mortgage Lending: Charting a Course Through the Regulatory Maze*, 29 VAND. L. REV. 956, 980-84 (1976) (discussing the potential liability to management of institutions which made socially-responsible high-risk loans, due to the lack of clear authority for such a policy); Willie, *A Regulator's View of Banks in Community Development*, 29 VAND. L. REV. 935 (1976) (in which the Chairman of the F.D.I.C. conceded that past examination procedures discouraged rehabilitation or development loans).



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outright deny an application. Depository institutions are subject to extensive and sometimes highly discretionary supervision throughout their operations.<sup>131</sup> "Suggestions" and "encouragement" from supervisory authorities, even when not explicitly coercive, are taken seriously.<sup>132</sup> C.R.A. has tended to reverse the nature of supervisory criticism. Where once the agencies would criticize for lending locally (if higher returns were available elsewhere), now the agencies will criticize for failing to lend locally.<sup>133</sup>

The dangers of noncompliance with C.R.A. are especially clear for institutions planning interstate expansion or other acquisitions.<sup>134</sup> Any institution, however, has some incentive to comply. Even relatively minor decisions, such as relocating an office, trigger C.R.A. reviews, and cannot always be predicted. Economic conditions change over time, as do business decisions and philosophies. When an application is filed, review entails consideration of the record not only during the year of application but also in previous years. Inattention to C.R.A. in one year may therefore jeopardize future options.<sup>135</sup>

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131. One representative of the thrift industry noted, in regard to C.R.A. implementation, that "the supervisory agencies have rather awesome powers and broad discretion in the exercise of those powers. This is particularly true with respect to examinations, the approval of mergers and acquisitions, and the approval of applications for new deposit facilities." R. Dockson, Testimony on Behalf of the California Savings and Loan League and the Conference of Federal Savings and Loan Ass'ns on the Community Reinvestment Act of 1977, before the Comptroller of the Currency, F.D.I.C., F.H.L.B.B., and F.R.B., 13 (Apr. 13, 1978).

132. This factor arose repeatedly in interviews by the author of officials of the four federal regulatory agencies. A member of the Federal Reserve Staff, for example, described major changes in the conduct of several banks on issues related to C.R.A., due to supervisory pressure and persuasion applied over several years. Telephone conversation with James W. Lowell, Community Affairs Coordinator, Division of Consumer and Community Affairs, F.R.B., Washington, D.C. (July 3, 1985).

133. See Scott, *The Patchwork Quilt: State and Federal Roles in Bank Regulation*, 32 STAN. L. REV. 687, 696-97 (1980); S. REP. NO. 175, *supra* note 22, at 33-35.

134. A depository institution that expects to file an application for approval of a merger, acquisition, or office change is more exposed to pressure than one that does not foresee any transaction that would trigger the requirement for regulatory approval. Note, *Legislating Against Mortgage Redlining: The Need for a Firmer Commitment*, 12 RUTGERS L.J. 151, 180 (1980); Comment, *Redlining, Disinvestment, and the Role of Mutual Savings Banks: Survey of Solutions*, 9 FORDHAM URB. L.J. 89 (1980). In states with "unit banking" laws, in which branching is not possible regardless of an institution's C.R.A. record, C.R.A. may have less effect. W. DENNIS & J. POTTINGER, *supra* note 5, at 9-5.

135. W. DENNIS & J. POTTINGER, *supra* note 5, at 11-7. Also, at least one agency has suggested that disregard of C.R.A. might lead to adverse consequences even when no application was pending or contemplated. F.H.L.B.B. officials stated that a savings and loan association following that policy "is probably not in compliance with the nondiscrimination requirements" based on the "effects test," and could be subject to a cease and desist order. *C.R.A. Examination Procedures Discussed*, 3 ON THE HOME FRONT, NO. 2, at 2 (F.H.L.B., San Francisco 1982) (copies on file at the *Pacific Law Journal*).



As a result of all of these factors, depository institutions have strong incentives to be attentive to the record of C.R.A. compliance that they are developing, and responsive to the requests of community activists. Even the threat of a protest tends to bring depository institutions to the bargaining table.<sup>136</sup>

### B. Costs and Effects

Institutions have demonstrated substantial ingenuity in developing community investment strategies. In a broad variety of permutations, institutions have embarked on programs to lend in declining neighborhoods for construction, purchase, or rehabilitation, and to offer these loans at favorable rates. Counselling services or special consideration is provided for loan applicants who might otherwise be denied, and efforts are made to stimulate loan applications from some neighborhoods.<sup>137</sup> Some banks have formed consortia for concentrated lending in target communities, thereby reducing the risk assumed by each lender.<sup>138</sup> Many banks have participated in revitalization programs subsidized or assisted in a variety of manners by local and federal governments, but relying principally on private

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136. Ansbury, *supra* note 110, at 58, cols. 1-5 (reporting comments by a Federal Reserve official, community groups, and bankers).

Interviews with both community group and supervisory agency representatives emphasized that one of the primary aspects of a community group's leverage or negotiating power is the delay that could arise in the processing of a bank's application if the group files a protest. Telephone conversation with Tom Schraw, National People's Action, Chicago, Illinois (July 3, 1985); telephone conversation with James W. Lowell, Community Affairs Coordinator, Division of Consumer and Community Affairs Coordinator, Division of Consumer and Community Affairs, F.R.B., Washington, D.C. (July 3, 1985). See also V. BENEDEK, *supra* note 37, at 52 (delay of four months in application of Society National Bank in Cleveland), 67 (delay of 15 months in case of Northside Savings Bank of New York, leading to a dramatic change in policy by the bank and withdrawal of opposition by the community group), 98 (mere threat of delay lead to quick concessions due to competition before the regulator from two other institutions applying for a branch in the same location).

137. For description of such efforts see Dennis, *The Dual Housing Credit Market*, *supra* note 19 (including 28 examples of policies or programs instituted by banks under C.R.A. pressure); D. MARINO & L. ROSSER, SAVINGS AND LOAN SERVICE CORPORATIONS AS INSTRUMENTS OF REINVESTMENT (Woodstock Inst. 1977); M. ADAMS & L. ROSSER, COMMUNITY DEVELOPMENT SUBSIDIARIES OF BANK HOLDING COMPANIES AS VEHICLES OF REINVESTMENT (Woodstock Inst. 1977), reprinted in Dennis, *The Dual Housing Credit Market*, *supra* note 19, at 338-59.

138. One example is the Crown Heights Revitalization Group formed by 14 New York City banks to stimulate investment and to operate an office that assists potential borrowers in "packaging" applications for multi-family rehabilitation and other types of loans (i.e. assembling and organizing the necessary data into a formal and complete presentation). Also in New York, 26 savings banks are members of a program which reconsiders loan applications which have been denied, and grants them if the denial is considered improper. MORTGAGE REVIEW FUND (brochure, undated, obtained in 1981) (copies on file at the *Pacific Law Journal*).

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capital.<sup>139</sup> Lenders also use programs operated by Federal Housing Administration (F.H.A.), Veterans Administration (V.A.), and Small Business Administration (S.B.A). Of course, many of these strategies do entail greater administrative effort and expense than the lenders would prefer.

The record-keeping burden imposed directly by C.R.A. is quite limited. The only paperwork that is mandated is the C.R.A. Statement (usually only a few pages), and the duty to maintain a file of comments received from the public. Nevertheless, the fact that C.R.A. activities are subject to regulatory review prompts some banks to maintain additional documentation. Advisors to lending institutions recommend preparation of extensive documentation of all factors that reflect favorably on the bank in a C.R.A. review. For example, institutions are counselled to prepare a response to every negative comment in the public file, to consider ways "to generate honestly deserved favorable comments," and to document all contacts with community groups.<sup>140</sup> In addition, depository institutions may be well advised to record the factors considered in delineating the community to be served and the credit services to be provided, and to document any C.R.A. training given to staff.

### V. THE FEDERAL SUPERVISORY AGENCIES

C.R.A. mandated, and has begun to accomplish, a shift in the attitudes and policies of the four federal financial supervisory agencies. The mission of the agencies, the Federal Home Loan Bank Board, the Comptroller of Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board, had always been to assure that depository institutions serve the "convenience and needs" of their communities.<sup>141</sup> Prior to C.R.A., however, the agencies

139. See, e.g., F.H.L.B., N.Y., *PROGRESS THROUGH PARTNERSHIP, A REPORT ON COMMUNITY INVESTMENT ACTIVITY IN DISTRICT 2* (N.Y., N.J., P.R.), June 1978 to Dec. 1979 (no date) (stating that approximately 99 savings and loans nationally were participating in the F.H.L.B.B. Community Investment Fund, providing dozens of examples) (copies on file at the *Pacific Law Journal*); Dennis, *The Dual Housing Credit Market*, *supra* note 19 (providing 21 examples).

140. W. DENNIS & J. POTTINGER, *supra* note 5, at 9-24. Accord Healey, *supra* note 58. However, a Federal Reserve staff member with years of experience in C.R.A. matters stated that only a very few banks (usually very large ones) maintain documentation beyond what is minimally necessary. Telephone conversation with James W. Lowell, Community Affairs Coordinator, Division of Consumer and Community Affairs, F.R.B., Washington, D.C. (July 3, 1985). One community group reported, in regard to a particular savings and loan association, that "every time they talked to one person in the neighborhood, they recorded it." V. BENEDEK, *supra* note 37, at 16.

141. The "convenience and needs" formula is used in 12 U.S.C. §§ 1816 (1982) (for certificate to do business), 1828(c)(5) (for mergers), 1942(c) (for acquisition of bank shares).

interpreted this mission as requiring an exclusive focus on financial "safety and soundness," promoted by pursuit of maximum income consistent with very limited risk, for the benefit of the institution's depositors and shareholders.<sup>142</sup> Thus, for example, if a depository institution located in New York (and originally chartered for the purpose of serving the "convenience and needs of its community"),<sup>143</sup> could earn a higher interest rate on real estate loans in California, the supervisory agencies would criticize the institution for failing to export capital.<sup>144</sup> The detrimental impact on local loan applicants and local neighborhoods simply did not enter the equation.

In the congressional hearings that led to C.R.A., the agencies made their attitudes and orientations clear. They agreed that depository institutions that do not meet community credit needs exist, but could not cite a single example of an institution being denied an application for that reason.<sup>145</sup> The agencies opposed the notion that matters of social policy or neighborhood improvement were within their mission.<sup>146</sup>

These attitudes of the management and staff of the supervisory agencies appear to be changing as a result of C.R.A., though the rate of progress ranges between slow and glacially slow. Enforcement of C.R.A., like enforcement of civil rights and consumer protection statutes, is often considered inconsistent with the agencies' traditional

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142. Scott, *The Patchwork Quilt: State and Federal Roles in Bank Regulation*, 32 STAN. L. REV. 687, 696-97 (1980); S. REP. No. 175, *supra* note 22, at 33-35.

143. See *supra* notes 50 & 51 and accompanying text.

144. See, e.g., statements by Garth Marston, Chairman of the F.H.L.B.B. in the hearings on C.R.A. *Hearings on S. 406, supra* note 2, at 239, 248, 266 ("In 1974 the usury limit in the District [of Columbia] was 8 percent. In Virginia and Maryland, it was 10 percent. Why lend money in the District?"). Expressing a similar view, the Federal Reserve Board described the ability of a multibranch bank to use deposits received in one area to make loans elsewhere as an advantage, not a disadvantage. Midland Bank Ltd., 67 Fed. Res. Bull. 729 (1981).

145. *Hearings on S. 406, supra* note 2, at 397 (statement of Senator Proxmire, commenting on the testimony presented at the hearings).

146. *Id.* at 236 (Prepared Statement of Garth Marston, Chairman, F.H.L.B.B.). Similarly, in hearings two years prior to enactment of C.R.A., the agencies discounted the incidence of redlining and denied that depository institutions had any obligation to lend in their own neighborhoods. *Home Mortgage Act of 1975: Hearings on S. 1281 Before the Comm. on Banking, Housing and Urban Affairs 94th Cong., 1st Sess.* (1975). According to the F.H.L.B.B., for example, "evidence of intentional discrimination against specific areas has been elusive at best," and "thrift institutions are wisely under no legal obligation to invest in any given neighborhood." *Id.* at 594, 597, 600 (statement of Thomas Bomar, Chairman, F.H.L.B.B.). According to the Federal Reserve, "[t]o insist that capital should not flow out of a lender's market is to risk inhibiting . . . economic growth in the nation as a whole." *Id.* at 20, 21 (letter from Arthur F. Burns, Chairman, Board of Governors, Federal Reserve System). According to F.D.I.C., "there is serious question whether banks should be encouraged to make real estate loans in certain deteriorated neighborhoods . . ." *Id.* at 19 (letter from Frank Wille, Chairman, F.D.I.C.).

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concentration on "safety and soundness," and is assigned a low priority.<sup>147</sup>

The agencies have taken steps to obtain necessary data for C.R.A. reviews. Most agencies, for example, require depository institutions to maintain registers or logs of loan applications, which provides a basis for analysis of lending policy according to racial characteristics, income levels, and neighborhoods.<sup>148</sup> "Geocoding" of approved loans is used to analyze the geographic distribution of loans, with particular attention to low- and moderate-income neighborhoods, and to neighborhoods with minority populations. In most agencies, computerized systems are used to identify statistical disparities that justify particular attention by bank examiners.<sup>149</sup> The agencies also assist lending institutions in using federal programs which permit them to increase lending in low- and moderate-income neighborhoods without incurring excessive risk or accepting below-market rates of return.<sup>150</sup>

147. A survey by F.D.I.C. of F.R.B., O.C.C., and F.D.I.C. managers and examiners in 1979 found that compliance with consumer protection laws and regulations was considered to be the least important aspect of examinations. GEN. ACCT. OFF., EXAMINATIONS OF FINANCIAL INSTITUTIONS DO NOT ASSURE COMPLIANCE WITH CONSUMER CREDIT LAWS 7 (1981) [hereinafter cited as G.A.O., STUDY]. In 1980, some managers and examiners expressed similar views, and also concerns regarding limited career opportunities in their consumer compliance role. *Id.* at 8. The Chairman of F.D.I.C. indicated that the agency was aware of the concerns and was working to change the perceptions. Letter from Irvine H. Sprague, Chairman, F.D.I.C., to William J. Anderson, General Accounting Office (Oct. 24, 1980), reprinted in *id.* 49, 55. A study for the F.R.B. in 1978 found widespread perceptions among examiners that enforcement of civil rights law might be inconsistent with their efforts to maintain the safety and soundness of banks, was not considered highly important by the Federal Reserve Board, and would not materially advance the examiners' careers in the System. W. DENNIS, THE DETECTION AND CORRECTION OF CREDIT DISCRIMINATION: A REPORT TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM 9 (1978). Five years later, in 1983, another study of F.R.B. staff found that few compliance examiners "feel comfortable" advising banks to improve C.R.A. performance, and several "thought that their performance in these areas was limited by the attitude of the management of their Reserve Banks." CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63, at 4.6.

148. Loan application registers or logs, including information on racial characteristics, are required routinely by F.H.L.B.B. and F.D.I.C., and are required in special cases by O.C.C., but are not required by F.R.B. J.R.B. ASSOCS., PREPARED FOR FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL: SECTION 340(e) FAIR HOUSING LENDING STUDY: FINAL REPORT, at S-2 (unpublished report July 30, 1982) [hereinafter cited as SECTION 340(e) REPORT]; 12 C.F.R. §§ 338.4 (1986) (F.D.I.C.), 528, 6 (F.H.L.B.B.), 27 (O.C.C.).

149. F.H.L.B.B. has an automated Loan Application Register System (LARS), F.D.I.C. has a Computer Assisted Supervisory System (COMPASS), and O.C.C. has a Fair Housing Home Loan Data System (FHHLDS). F.R.B. has no computerized system for reporting and processing data relevant to discrimination in lending policy regulated depository institutions. SECTION 340(e) REPORT, *supra* note 148, at S-2, 3-1 to 3-5. The Federal Financial Institutions Examinations Council, in response to § 340(e) of the Housing and Community Development Act of 1980, Pub. L. No. 96-399 (1980), has prepared a study of the feasibility of a single system to be used by all four agencies. *Id.*; Fed. Fin. Insts. Exam. Coun., Fair Lending and Community Reinvestment, 47 Fed. Reg. 41,421, 41,422 (1982).

150. See, e.g., COMPT. CURR., PROGRAM GUIDEBOOK TO HELP MEET COMMUNITY CREDIT

Beyond these basic administrative measures, however, the C.R.A. compliance program appears to be extremely limited. Among the most powerful forms of "encouragement" would be suggestions or informal communications from agency staff to lender management, particularly in the course of periodic bank examinations. In actual practice, however, these enforcement powers are rarely used. Separate studies by the General Accounting Office,<sup>151</sup> a congressional subcommittee,<sup>152</sup> and others,<sup>153</sup> have found that neither informal contacts nor examination reports are regularly and effectively used to promote C.R.A. compliance.

The supervisory agencies' bank examiners tend to focus on technical or procedural requirements, such as proper posting of required notices. They direct inadequate attention to the far more difficult, time-consuming analytic task of identifying geographic discrimination and other practices violative of C.R.A.'s basic purposes.<sup>154</sup> Bank examiners typically have not contacted community groups, thus limiting their review to data supplied by the bank.<sup>155</sup> This policy was only

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NEEDS: A GUIDEBOOK FOR BANKS AND BANK EXAMINERS (1979) (describing dozens of such programs).

151. G.A.O., STUDY, *supra* note 147.

152. *Hearing on C.R.A. Compliance*, *supra* note 94.

153. Ctr. for Community Change, Neighborhood Revitalization Project, Adequacy of C.R.A. Enforcement, *reprinted in Hearing on C.R.A. Compliance*, *supra* note 94, at 172 [hereinafter cited as Ctr. for Community Change, Adequacy]; Statement of Howard Golden, President of the Borough of Brooklyn in *Hearing on C.R.A. Compliance*, *supra* note 94, at 8. The Brooklyn President, whose office has made substantial comment on almost every application for expansion of a bank in Brooklyn, concluded that "the intent and mandate of CRA was not sufficient to overcome the historic reluctance regulators have to seriously question, pressure, and force banks to operate in the community interest." *Id.* at 9.

154. G.A.O., STUDY, *supra* note 147; Ctr. for Community Change, Adequacy, *supra* note 153; CON. ADV. COUN., THE FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63. The General Accounting Office stated:

Our conclusions are based principally on the lack of documented analysis, such as a comparison of rejected loans to accepted loans, analysis of monitoring information for real estate related loans, and the use of HMDA data for geocoding (plotting approved loans on a delineated map of the institution's community) to assess CRA.

G.A.O., STUDY, *supra* note 147, at 5-6. The study's findings as to C.R.A. enforcement was qualified by the notation that data on C.R.A. enforcement was limited, because the law was recent, but the findings were nevertheless consistent with patterns of enforcement of the Equal Credit Opportunity, Fair Housing, and Truth in Lending Acts. *Id.* The community group found that C.R.A. examinations "concentrate on technical (and) largely inconsequential aspects of compliance." Ctr. for Community Change, Adequacy, *supra* note 153. The F.R.B.'s advisory council, in its study of the agency's compliance examiners and community affairs officers, "recurrently encountered mere technical compliance with the law; that is, doing no more than is necessary." CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63, at 3.3.

155. G.A.O. STUDY, *supra* note 147; Ctr. for Community Change, Adequacy, *supra* note 153.

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recently changed.<sup>156</sup> When violations are identified, compliance techniques are mild and permissive, rarely going beyond mere moral suasion.<sup>157</sup>

Ultimately, the coercive aspect of C.R.A. becomes most apparent in formal decisions on applications for branches or mergers. These decisions, which are publicly disclosed, perform a function comparable to that of judicial decisions, interpreting a statute and applying it to concrete fact situations. The formal rulings of the agencies are

156. The Federal Reserve reported, for example, that, in 1982, its examiners conducted 1,271 interviews with government officials, community groups, and trade associations, in connection with consumer compliance examinations. *BD. GOV. FED. RES. SYS.*, 69TH ANN. REP. 159 (1983). Nevertheless, a survey of community leaders by the F.R.B.'s advisory council in 1983 found that 94% of the respondents knew about C.R.A. and were actively involved in community development, but only 30% had ever been contacted by the F.R.B.'s community affairs officers. *CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A.*, *supra* note 63, at 4.5.

157. G.A.O., *STUDY*, *supra* note 147; *Ctr. for Community Change, Adequacy*, *supra* note 153. According to the General Accounting Office, the agencies continued to rely on moral suasion even after persistent violations, commonly simply repeating their ineffective efforts, without even using a more strongly worded letter or request for evidence of correction. *Id.* at 34-35. In response to these findings, the F.D.I.C. noted that legal proceedings are expensive, and that "supervisory pressures brought to bear over a period of time" frequently produce the desired result. Letter from Irvine H. Sprague, Chairman, F.D.I.C. to William J. Anderson, G.A.O. (Oct. 24, 1980), *reprinted in* G.A.O., *STUDY*, *supra* note 147, at 49, 57.

According to a community group report, there is "overwhelming rating inflation of CRA examinations," with less than five percent receiving ratings less than satisfactory, and even those receive no supervisory follow-up between examination cycles. *Ctr. for Community Change, Adequacy*, *supra* note 153. Data released by the Federal Financial Institutions Examinations Council on C.R.A. ratings issued in 1983 tends to support that conclusion. The data combines the ratings issued by F.R.B., F.D.I.C., and O.C.C., which used the same adjectives to describe each rating, and can be summarized as follows:

| C.R.A. Rating                                        | Number | Percentage |
|------------------------------------------------------|--------|------------|
| 1 - commendable, need no further improvement         | 1,099  | 20.2%      |
| 2 - satisfactory, but may need further encouragement | 4,4145 | 76.3%      |
| 3 - less than satisfactory                           | 173    | 3.2%       |
| 4 - much less than satisfactory                      | 10     | 0.2%       |
| 5 - unsatisfactory                                   | 2      | 0.0%       |
| TOTALS                                               | 5,429  | 100.0%     |

Data for the F.H.L.B.B., which assigned different adjectives to the same numerical scale, was described in text format that can be summarized as follows:

| C.R.A. Rating         | Number | Percentage |
|-----------------------|--------|------------|
| 1 - outstanding*      |        |            |
| 2 - good*             | 91     | 4.2%       |
| 3 - satisfactory      | 2,050  | 95.1%      |
| 4 - needs improvement | 13     | 0.6%       |
| 5 - unsatisfactory    | 1      | 0.0%       |
| TOTALS                | 2,155  | 100.0%     |

\* Data for ratings 1 and 2 were not separately stated. *LENDERS COMMUNITY INV. REP.*, CRA AGGREGATE RATINGS PUBLISHED BY BANK REGULATORS 3 (Community Inv. Publ., Silver Spring, Md. Sept. 1984).



particularly crucial because of the extremely imprecise nature of the C.R.A. They inevitably send messages to the banking industry as to the types of conduct that are deemed unacceptable by the regulatory agencies, and the consequences to be expected.

Denial or conditional approval of a bank application is certainly not the only, nor even necessarily the most effective, means of promoting compliance. Nevertheless, the record of formal rulings is an important element in assessing the agencies' commitment to enforcing C.R.A., and is watched carefully by the banking industry.

To date, in most agencies, the incidence of formal sanctions is so minimal as to suggest that a noncomplying depository institution faces no significant danger of denial of an application to branch out or merge. In the years since the effective date of C.R.A., the nation's thousands of regulated depository institutions have filed thousands of applications, including approximately 100 that were formally protested. The number denied or conditionally approved on C.R.A. grounds by all four agencies is minimal, perhaps only four. The number approved subject to conditions is only slightly larger, perhaps twenty-eight.<sup>158</sup>

158. The two compilations of data on disposition of depository institution applications involving significant C.R.A. issues produced somewhat differing results, probably due to differences in format and methodology. A community organization offers data that can be summarized as follows:

|            | F.D.I.C. | F.H.L.B.B. | F.R.B. | O.C.C. |
|------------|----------|------------|--------|--------|
| Denied     | 3        | 0          | 0      | 1      |
| conditions | 0        | 23         | 1      | 3      |

Comments of Allen J. Fishbein, Director, Neighborhood Revitalization Project, Center for Community Change, in *Con. Adv. Coun., Bd. Gov. Fed. Res. Sys. Discussion of Current Credit Conditions and the Community Reinvestment Act 9* (unpublished Apr. 29, 1982) [hereinafter cited as *Discussion*]. A study prepared for the F.R.B. produced the following data on applications involving significant C.R.A. issues between October 1977 and March 1982:

|                                            | F.D.I.C. | F.H.L.B.B. | F.R.B. | O.C.C. |
|--------------------------------------------|----------|------------|--------|--------|
| Denied                                     | 3        | 0          | 0      | 1      |
| Approved with conditions or commitments    | 3        | 8          | 8      | 7      |
| Approved without conditions or commitments | 19       | 18         | 11     | 26     |
| Withdrawn                                  | 2        | Not avail. | 0      | 2      |
| Withdrawn following negotiated agreements  | 9        | 7          | 7      | 5      |

CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63, Table F6.1. Whichever set of figures is accepted, it is clear that the number of applications receiving unfavorable action is miniscule in relation to the total number of applications considered.

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To consider the supervisory agencies as a whole, however, is insufficient. Analysis of the publicly-available data regarding the policies and the results of the C.R.A. enforcement programs indicates distinctly divergent patterns among the four agencies.

### A. Federal Home Loan Bank Board

The Federal Home Loan Bank Board (F.H.L.B.B.) regulates savings and loan associations, which have traditionally represented the primary institutional source of residential mortgage credit,<sup>159</sup> a major focus of C.R.A. In comparison to the other federal regulatory agencies, the F.H.L.B.B. has demonstrated exceptional vigor and commitment to effectuating the policies embodied in the C.R.A. Its success, however, has been seriously impeded by the severe financial difficulties experienced by savings and loan associations in recent years (problems more serious than those facing other branches of the banking industry).

The investment portfolios of savings and loan associations consisted overwhelmingly of residential mortgages with long terms and fixed interest rates.<sup>160</sup> The associations, therefore, suffered severely as rapidly rising interest rates and new competition from money market funds caused income from old loans to fall below the expense of attracting new deposits.<sup>161</sup> Profitability of the savings and loan industry began a steady decline in 1978, becoming negative in 1981 and 1982. Hundreds of savings and loan associations were forced into dissolution or into merger to avoid dissolution.<sup>162</sup> A modest

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Using as an example a single agency in a single year, the F.R.B. considered 1,597 applications in 1982. *Id.* at 1.2.

159. In 1976, the savings and loan industry originated approximately 55% of all institutional home mortgage lending. 1981 ANN. REP., 15 FED. HOME LOAN BANK BD. J., No. 4, 22 (1982). By 1981, however, due to severe economic problems this percentage was down to eight percent. *Id.*

Although the F.H.L.B.B. has authority in some respects over all thrift institutions having federal charters or federal deposit insurance, its authority under C.R.A. is limited to those with federal charters. State-chartered associations, representing approximately half of the assets held by all savings and loans in the nation, do not require the F.H.L.B.B.'s approval to open new branches, even if they have federal deposit insurance. W. DENNIS & J. POTTINGER, *supra* note 5, at 9-5, 10-5.

160. Moran, *Thrift Institutions in Recent Years*, 68 Fed. Res. Bull. 726 (1982).

161. Excellent summaries of the causes and effects of the severe problems encountered by thrift institutions are in 1982 ANN. REP., 16 FED. HOME LOAN BANK BD. J., No. 4 (1983); and Moran, *Thrift Institutions in Recent Years*, 68 Fed. Res. Bull. 725, 726 (1982).

162. Mahoney & White, *The Thrift Industry in Transition*, 71 Fed. Res. Bull. 137, 138 (1985). In 1982 alone, there were 446 mergers, including 167 directed by the F.H.L.B.B.—an unprecedented number. 1982 ANN. REP., 16 FED. HOME LOAN BANK BD. J., No. 4, at 4 (1983).

recovery began in 1983 and 1984, but earnings are still well below the performance of the early 1970s.<sup>163</sup>

An economic environment more adverse for initial implementation of C.R.A. could hardly be imagined. A depository institution threatened with economic collapse clearly cannot be expected to aggressively market credit services that might aggravate the problem. Moreover, it would be pointless to promote mortgage credit in low- and moderate-income neighborhoods when prevailing market interest rates are so high that even most high-income families cannot afford to borrow.<sup>164</sup>

Despite the circumstances, the F.H.L.B.B. has acted with some vigor to implement C.R.A. The Board is the only one of the four supervisory agencies to commit its own funds for C.R.A.-oriented lending. A "Community Investment Fund" of ten billion dollars advances funds to savings and loan associations for specific community investment projects, at an interest rate of one-half percent below the otherwise prevailing Federal Home Loan Bank rate. The participating association bears the risk of default by the ultimate borrower.<sup>165</sup> The program has been described as "by far the biggest 'carrot' so far devised to encourage reinvestment," accompanying the C.R.A. "stick."<sup>166</sup>

The F.H.L.B.B. has taken the lead, among the four supervisory agencies,<sup>167</sup> in issuing nondiscrimination requirements addressing a variety of practices associated with redlining.<sup>168</sup> The intent is to limit the basis of lending decisions to objective criteria demonstrably related to creditworthiness of the applicant and value of the property offered as security, and to exclude all unsubstantiated assumptions about groups and areas.<sup>169</sup>

163. Mahoney & White, *The Thrift Industry in Transition*, 71 Fed. Res. Bull. 137, 137 (1985). See also Moran, *Thrift Institutions in Recent Years*, 68 Fed. Res. Bull. 726 (1982).

164. The average effective mortgage commitment rate offered by thrift institutions in October 1981 was over 18%. 1982 ANN. REP., 16 FED. HOME LOAN BANK BD. J., No. 4, 23-24 (1982).

165. NAT'L TRAIN. & INFO. CTR., PASS THE BUCK . . . BACK: THE C.R.A. HANDBOOK 115 (1979).

166. *Id.* For a description of projects and results, see 1982 ANN. REP., 16 FED. HOME LOAN BANK BD. J., No. 4, 34-37 (1982).

167. S. REP. 175, *supra* note 43, at 33.

168. 12 C.F.R. §§ 528, 531 (1986). Prior to C.R.A., the F.H.L.B.B. had established a reputation as the most active of the four agencies in antidiscrimination efforts. Searing, *supra* note 39, at 1127-43; Lamb, *supra* note 28, at 411.

169. 12 C.F.R. § 531.8(b), (c) (1986). Building age and location data may not be used as a basis for discouraging or refusing to accept a loan application, 12 C.F.R. § 528.3 (1986); denying a loan or discriminating in fixing any of its terms or conditions, 12 C.F.R. § 528.2(a) (1986); and may not be used in a discriminatory manner in appraisal, 12 C.F.R. § 528.2a(a)

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Use of age or location of the collateral as factors in the appraisal and loan review process is severely restricted.<sup>170</sup> Excluded from consideration are the race, color, religion, sex, or national origin of the loan applicant and of other persons in the dwelling or its vicinity. The Board further cautions that consideration of the income level of the area in which the collateral is located can lead to discrimination against minorities.<sup>171</sup>

The F.H.L.B.B. applies the "effects test"<sup>172</sup> of discrimination both to loan underwriting standards and to more general decisions concerning the types and terms of loans to be offered. A lending standard that is discriminatory in effect may not be used, even in the absence of actual intent to discriminate, unless it "achieves a genuine business need which cannot be achieved by means which are not discriminatory in effect or less discriminatory in effect."<sup>173</sup>

Thrift institutions are cautioned about "credit rationing," a term the Board uses to describe such measures as restricting the types of loans offered, requiring larger down payments, and increasing the credit requirements for approval of a loan application. The institutions are to evaluate whether any such measures have a disproportionately negative impact on particular groups or areas, even if unintended or not immediately apparent.<sup>174</sup>

Formal rulings on applications submitted by thrift institutions point to all of these regulations, which connect closely with the C.R.A. standards. Although the Board has not yet issued any denials of applications on C.R.A. grounds, this fact in context does not demonstrate laxity in enforcement. F.H.L.B.B. staff informally advise savings and loan associations of the likelihood of unfavorable action

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(1986).

The F.H.L.B.B., it has been noted, is the only one of the four agencies to regularly use the term "redlining" without quotation marks and without any implication that it may not exist. W. DENNIS & J. POTTINGER, *supra* note 5, at 10-7.

170. 12 C.F.R. § 528.2(a) (1986).

171. 12 C.F.R. § 531.8(c)(6) (1986).

172. The "effects test," as developed in Supreme Court decisions (based on legislation other than C.R.A.) "proscribes not only overt discrimination but also practices that are fair in form but discriminatory in operation." *Griggs v. Duke Power Co.*, 401 U.S. 424, 431 (1971). Once the plaintiff shows a discriminatory effect, the burden shifts to the defendant to prove a sufficient business justification of the practice. *Id.* *Albermarle Paper Co. v. Moody*, 422 U.S. 405 (1975).

173. 12 C.F.R. § 531.8(b) (1986).

174. Statement on Credit Rationing, F.H.L.B.B. Res. No. 79-547 (Nov. 1, 1979), 44 Fed. Reg. 63,182-83 (Nov. 9, 1979). The Statement was prompted by "periods of economic stringency," but since every financial institution always "rations" credit in the sense of selecting a finite number of investments from among a much larger number of opportunities, the Statement should have general applicability.

by the Board. The associations withdraw applications likely to be denied, thereby avoiding formal public denial.<sup>175</sup> Withdrawal under such circumstances accomplishes the same purpose as denial.

Resolutions of the Board commonly contain "conditions" to approval, or approve an application "provided that" specified measures are adopted by the savings and loan association. More than seventy resolutions have contained such provisions, which typically require corrective action within a specified short period of time.<sup>176</sup> The most common requirement is affirmative lending and marketing directed towards low- and moderate-income neighborhoods.<sup>177</sup> Some associations are required to reexamine the delineation of their communities and make appropriate changes.<sup>178</sup>

Many associations are instructed to alter credit rationing policies which are discriminatory in effect. Some of those policies are facially neutral but tend to perpetuate past patterns of discrimination. Examples include policies to lend only to previous customers,<sup>179</sup> to charge increased interest rates or fees for loans in certain geographic areas,<sup>180</sup> to apply arbitrary standards of "remaining economic life" of a building,<sup>181</sup> or to consider applications for conventional loans

175. Telephone interview with Tom Wall, Director, Office of Community Investment, F.H.L.B.B., Washington, D.C. (May 12, 1982). Mr. Wall indicated that the institution takes steps to improve its C.R.A. record before submitting another application.

176. The Resolutions and institutions affected include the following:

F.H.L.B.B. Res. No. 79-348 (May 14, 1979) (State Federal Sav. & Loan Ass'n, Beatrice, Neb.); F.H.L.B.B. Res. No. 79-357 (June 21, 1979) (First Federal Sav. & Loan Ass'n, Toledo, Ohio); F.H.L.B.B. Res. No. 79-637 (Dec. 13, 1979) (Northwestern Fed. Sav. & Loan Ass'n, Clay Center, Kan.); F.H.L.B.B. Res. No. 80-124 (Mar. 3, 1980) (American Fed. Sav. & Loan Ass'n, Lynchburg, Va.); F.H.L.B.B. Res. No. 80-352 (May 29, 1980) (Biscayne Fed. Sav. & Loan Ass'n, Miami, Fla.); F.H.L.B.B. Res. No. 80-460 (July 24, 1980) (Continental Sav. Ass'n, Freeport, Tex.); F.H.L.B.B. Res. No. 80-493 (Aug. 15, 1980) (Freedom Fed. Sav. & Loan Ass'n, Worcester, Mass.); F.H.L.B.B. Res. No. 80-539 (Aug. 21, 1980) (Midwest Fed. Sav. & Loan Ass'n, Jamaica, N.Y.); F.H.L.B.B. Res. No. 80-618 (Sept. 30, 1980) (Reliance Fed. Sav. & Loan Ass'n, Jamaica, N.Y.); F.H.L.B.B. Res. No. 80-638 (Oct. 8, 1980) (Austin Fed. Sav. & Loan Ass'n, Chicago, Ill.); F.H.L.B.B. Res. No. 80-721 (Nov. 10, 1980) (Capitol City Fed. Sav. & Loan Ass'n, Washington, D.C.) (copies on file at the *Pacific Law Journal*).

Subsequent citations will be to Resolution Number only. Reports of the General Counsel, in the F.H.L.B.B.'s Annual Reports, indicate much larger number of conditional approvals: 26 in 1982, 17 in 1981, and 30 in 1980. 1982 ANN. REP., 16 FED. HOME LOAN BANK BD. J., No. 4, at 33 (1983); 1981 ANN. REP., 15 FED. HOME LOAN BANK BD. J., No. 4, at 41 (1982); 1980 ANN. REP., 14 FED. HOME LOAN BANK BD. J., No. 4, at 43 (1981).

177. See, e.g., Res. Nos. 79-367, 80-124, 80-352, 80-460, 80-638, 80-721, *supra* note 176.

178. See, e.g., Res. Nos. 80-493, 80-539, *supra* note 176.

179. Res. No. 79-367, *supra* note 176 (customer-only policy was to be abandoned outright in specified census tracts, and continued in the remainder of the community only if no less-discriminatory means could be found to achieve the same business need); Res. No. 79-637, *supra* note 176.

180. Res. Nos. 79-348, 79-637, 80-638, *supra* note 176.

181. Res. No. 80-618, *supra* note 176.



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with high loan-to-value ratios only upon special request.<sup>182</sup> Finally, some associations are admonished to increase lending in low- and moderate-income neighborhoods<sup>183</sup> and to consider offering additional types of loans.<sup>184</sup> The F.H.L.B.B. has not hesitated to specify necessary changes in a depository institution's lending criteria and programs.<sup>185</sup>

The policy on granting hearings to community groups on C.R.A. matters is fairly liberal. Any person who files a "substantial" protest<sup>186</sup> and makes a timely request will be granted an opportunity for oral argument "at a time and place reasonably convenient to the protestants."<sup>187</sup>

Overall, the F.H.L.B.B.'s record of C.R.A. enforcement appears to be the most vigorous of the four agencies. Commitment to the policies of C.R.A. is demonstrated in the investment of F.H.L.B.B. funds for community development projects, regulations addressing racial and geographic discrimination in housing credit in great detail, and rulings on applications submitted by regulated thrift institutions. Although the program is impeded by serious economic problems of the savings and loan industry, the effort is being made.

### B. Comptroller of the Currency

In the first few years after C.R.A.'s enactment, the Office of the Comptroller of the Currency (O.C.C.), which is responsible for supervision of national banks, issued several formal rulings on bank applications<sup>188</sup> that indicated an active program of enforcement. More

182. *Id.*

183. *See, e.g.*, Res. No. 80-352, *supra* note 176; Res. No. 80-539, *supra* note 176 (thrift institution near an Indian reservation was required to lend on the reservation, unless it could demonstrate that the tribal court did not provide a forum for enforcement of security interests).

184. *See, e.g.*, Res. No. 80-493, *supra* note 176 (thrift institution was to consider offering loans with a loan-to-value ratio up to .95%).

185. W. DENNIS & J. POTTINGER, *supra* note 5, at 10-11 (noting the contrast between F.H.L.B.B. and F.R.B. policies).

186. A protest (whether based on C.R.A. or any other grounds) is "substantial" if it is in writing, seasonably filed, and contains specific objections supported by reasons, facts (including relevant economic or financial data), and a description of any adverse effects on the protestant which may result from approval of the application. 12 C.F.R. § 543.2(e)(4) (1986). However, an application based on C.R.A. "shall not be considered insubstantial merely because of the form in which it is submitted." 12 C.F.R. § 543(e)(5) (1986).

187. 12 C.F.R. § 543.2(f) (1986).

188. The public record of rulings is limited, because of O.C.C.'s policy of issuing decisions publicly only when they represent "a new or changed policy or presents issues of general importance to the public or the banking industry." 12 C.F.R. § 5.13 (1986). Only eight decisions relating to C.R.A. have been made public. Letters from Robert W. Hefner, Director,



recent rulings have not been publicly released, making assessment of current enforcement efforts difficult.

Between 1978 and 1981, at least four applications were denied, and at least eleven were approved subject to conditions.<sup>189</sup> Other applications were withdrawn by the applicant bank (perhaps to avoid

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Consumer Examinations Division, Comptroller of the Currency, Washington, D.C., to the author (Aug. 31, 1982 & June 28, 1983). The documents, in chronological order, are as follows:

1. *In re: The Greater N.Y. Sav. Bank, N.Y., Kings County, N.Y., Application for Consent to Establish a Branch (Denial)* (F.D.I.C. Apr. 23, 1979) (Decision Statement of the Director, Comptroller of the Currency) (favoring conditional approval instead of denial). In this document, the Comptroller was acting in his capacity as member of F.D.I.C., Board of Directors.
2. Application to Merge Bank of Ind., Nat'l Ass'n, Gary, Ind., into Ind. Interim Nat'l Bank (Organizing), Gary, Ind., Under the Charter of Ind. Interim Nat'l Bank, and with the Title of Bank of Ind., Nat'l Ass'n (Compt. Curr. Nov. 2, 1979) (denial).
3. Application of Marine Midland Bank, Buffalo, N.Y., to Convert from a Banking Inst. Chartered Under the N.Y. Banking Law to a Nat'l Banking Ass'n (Compt. Curr. Jan. 28, 1980) (approval).
4. Application to Merge First Nat'l Bank of Clermont County, Bethel, Ohio, into Soc'y Nat'l Bank of Cleveland, Cleveland, Ohio, Under the Charter of Soc'y Nat'l Bank of Cleveland, and with the Title of "Soc'y Nat'l Bank" (Compt. Curr. Mar. 21, 1980) (approval).
5. Community Reinvestment Act (CRA) Supplement to the Decision of the Comptroller of the Currency to Approve the Branch Applications Submitted by Mich. Nat'l Bank of Detroit, Detroit, Mich. (Compt. Curr. Apr. 24, 1980) (approval).
6. Application to Merge Bank of Ind., Nat'l Ass'n, Gary, Ind., into Ind. Interim Nat'l Bank (Organizing), Gary, Ind., Under the Charter of Ind. Interim Nat'l Bank, and with the Title of Bank of Ind., Nat'l Ass'n (Compt. Curr. Aug. 18, 1980) (conditional approval).
7. Letter from John F. Downey, Regional Administrator of National Banks, to Daniel J. Callahan, President, The Riggs National Bank of Washington, D.C. (Apr. 23, 1981) (conditional approval) (copies of 1-8 on file at *Pacific Law Journal*).
8. Letter from Joe Selby, Senior Deputy Comptroller for Operations, to Board of Directors, American Fletcher National Bank & Trust Co., Indianapolis, Indiana (June 19, 1981) (conditional approval).

The documents listed above will be cited hereinafter simply as "Decision," followed by the most distinctive word in the bank's name, and the year of decision if necessary for clarity, along with the item number.

189. The Office of the Comptroller has prepared summaries of the disposition of bank applications raising C.R.A. issues between 1978 and June 1983. Letters from Robert W. Hefner, Director, Consumer Examinations Division, Comptroller of the Currency, Washington, D.C., to the author (Aug. 31, 1982, with summaries enclosed, and June 28, 1983, stating that his office had no additional information). That data may be reduced to the following chart:

|                        | Contested | Noncontested | Total |
|------------------------|-----------|--------------|-------|
| Approved               | 28        | 8            | 36    |
| Conditionally approved | 7         | 4            | 11    |
| Withdrawn              | 4         | -            | 4     |
| Denied                 | 1         | 3            | 4     |
| Totals                 | 40        | 15           | 55    |

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unfavorable action by the Comptroller),<sup>190</sup> and some were approved only after the objections of "protestants" were satisfied.<sup>191</sup> Particularly significant is the fact that the Comptroller identified selected bank applications for special attention on C.R.A. matters as a matter of internal agency procedure, rather than limiting its role to reacting to protests lodged by community groups.<sup>192</sup> O.C.C. appeared to apply the "effects test" of discrimination.<sup>193</sup> Moreover, the agency considered the burden of proof in resolving protests to be on O.C.C. itself, rather than on the protestor or the bank.<sup>194</sup>

The impact that firm supervisory enforcement of C.R.A. can have on lending institution policy is clearly illustrated by two of the early decisions of the Comptroller, relating to two applications for approval of a merger filed by the Bank of Indiana. In response to the first application, the Comptroller found that "the bank has not demonstrated an affirmative approach to *any* CRA assessment factor."<sup>195</sup> The bank had shown clear tendencies to direct credit to the suburbs but not to the city, had engaged in discriminatory lending policies, and persisted in Equal Credit Opportunity violations even after being cited in Comptroller examinations.<sup>196</sup> The Comptroller was not mol-

190. *Id.* Of the four protested applications withdrawn by the banks, one did so by agreement with a community group, and another converted to a state charter. Information regarding the other two was not provided.

191. In at least three cases in which protested applications were approved, community groups reached an agreement with the bank and/or withdrew the protest.

Society Bank, as one example, altered its home improvement loan policies, reached an agreement with the protesting community group and agreed to consult with it in the future, and initiated an active program to market credit in underserved areas. Decision, *Society*, *supra* note 188, no. 4 (C.R.A. Supplement). The community group's account of the negotiating process is at V. BENEDEK, *supra* note 37, at 54.

In another case, Michigan Bank developed an affirmative marketing program, and promised to acquire and staff a "C.R.A. mobile unit" to ascertain and meet local credit needs and to meet with community groups. Decision, *Michigan*, *supra* note 188, no. 5. In both cases, the Comptroller indicated that the banks would be monitored in terms of the actions promised.

192. V. BENEDEK, *supra* note 37, at 103. O.C.C. denied at least three applications and conditionally approved four others in situations in which no protests were filed by community groups. See *supra* note 189. The Bank of Indiana case represented the first denial by any of the four agencies entirely on its own initiative. W. DENNIS & J. POTTINGER, *supra* note 5, at 10-37.

193. Under O.C.C. guidelines, examiners interviewing bank personnel are instructed to "[d]etermine whether bank policies regarding evaluation [of loan applications] have been reviewed under the 'effects test.'" W. DENNIS & J. POTTINGER, *supra* note 5, at App.-328. Moreover, when the O.C.C. identified disproportionately low levels of lending in lowand moderate-income neighborhoods, as in the Bank of Indiana case, it required the bank to increase its marketing efforts in the neighborhoods, even without proof of intentional discrimination. See *infra* note 201; W. DENNIS & J. POTTINGER, *supra* note 5, at 10-37.

194. Decision, *Indiana* (1979), *supra* note 188, no. 2, at 4.

195. *Id.* (emphasis added).

196. Decision, *Indiana* (1979), *supra* note 188, at 3. More specifically, the Comptroller found

lified by cosmetic improvements and commitments undertaken by the applicant during and immediately before the Comptroller's consideration of the application. The application was denied.<sup>197</sup>

Nine months later, Bank of Indiana reapplied, presenting a record of major reforms and meaningful commitments for future improvements.<sup>198</sup> These steps included active solicitation of loan applications from low- and moderate-income neighborhoods, surveys of credit needs, numerous meetings with community leaders, seminars for urban small businesses, elimination of discriminatory practices, and commitments of major sums for inner-city loans. This second application was approved, conditioned on still further improvement.<sup>199</sup>

When applications were conditionally approved, the reason commonly given was that an analysis of the bank's geographical distribution of loans indicate disproportionately low levels in low- and moderate-income neighborhoods. The fact that few applications for credit were received from those neighborhoods is not a sufficient explanation; the bank was required to agree to increase its marketing efforts to elicit demand for credit from the disfavored neighborhoods.<sup>200</sup> The Comptroller also insisted that a bank's commitment to modify its policies to help meet the credit needs of its community involve the highest levels of management.<sup>201</sup>

The applications that did receive full approval often showed evidence of similar policy changes by the applicant banks. Decisions of the Comptroller that approved applications often indicated that the bank improved its program for marketing credit services in less-wealthy areas, improved dialogue with community organizations, and, in some instances, reached agreement with protesting groups.

Decisions on bank applications involving C.R.A. issues have not been publicly released since 1981 and the statistics indicate that none have been denied.<sup>202</sup> One interpretation is that enough applications

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"no evidence of meaningful communication with members of the community," "no marketing or special credit-related programs," policies tending to discourage loan applicants from "credit availability between the city of Gary and its surrounding suburban communities," and "dramatic disparities" for housing-related credits between lower-income and higher-income census tracts. *Id.*

197. *Id.* at 4, 5.

198. Decision, *Indiana* (1980), *supra* note 188, no. 6 (C.R.A. Supplement).

199. *Id.* The 1979 and 1980 decisions are discussed in Mortimer, *Current Developments in C.R.A. Enforcement*, 98 *BANKING L.J.* 604, 609-10 (1981).

200. See, e.g., Decision, *Riggs*, *supra* note 188, no. 7.

201. See, e.g., *id.* Conditions attached to approvals include discussion of C.R.A. issues by the bank board of directors, regular reports to the board, and formation of top-level C.R.A. committees.

202. Reference to one decision in 1984 was located in a secondary source. Protestors had

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were denied or conditionally approved in the early years to convey to national banks the message that failure to maintain good C.R.A. performance can have serious consequences. Thereafter, "encouragement" provided through less drastic means received the banks' careful attention, obviating the need for further denials. Another possibility is that O.C.C. is no longer as committed to C.R.A. enforcement. In the absence of current publicly available data, any conclusions would be speculative.

#### C. Federal Deposit Insurance Corporation

The Federal Deposit Insurance Corporation (F.D.I.C.) was the first supervisory agency to deny a bank's application because of an inadequate C.R.A. record—a decision said to have "sent shock waves through the banking community."<sup>203</sup> The publicly disclosed record of F.D.I.C. rulings on bank applications is extremely limited,<sup>204</sup> but does include three denials of bank applications for branch offices.<sup>205</sup> In a fourth case, F.D.I.C. granted approval subject to certain conditions.<sup>206</sup> Although community group objections play an important

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objected to a bank's plan to "focus marketing efforts on upwardly mobile individuals." The Comptroller found that the plan did not necessarily derogate from the bank's commitment to serve all segments of local communities. Applications of Dimension Fin. Corp. to Charter 31 Nat'l Banks in 25 States (Compt. Curr. May 9, 1984), cited and discussed in Lobell, *supra* note 94, at 1087, 1087 n.71.

203. Mortimer, *supra* note 199, at 609. Two other commentators said that the decision "set an aggressive tone for the agency." W. DENNIS & J. POTTINGER, *supra* note 5, at 10-40.

204. The F.D.I.C. has publicly released only seven formal rulings. Telephone conversation with Roger Hood, Assistant General Counsel, F.D.I.C., Washington, D.C. (July 1, 1985). The documents, in chronological order are as follows:

1. *In re: The Greater New York Sav. Bank, N.Y., Kings County, N.Y., Application for Consent to Establish a Branch (Denial)* (F.D.I.C. Apr. 23, 1979), reprinted in DISCRIMINATION IN MORTGAGE CREDIT: REGULATION, LITIGATION, AND COMPLIANCE 425 (W. Dennis & D. Glascoff eds. Prac. L. Inst. 1979).

2. *In re: Citizens Bank & Trust Co. of Md., Riverdale, Prince Georges County, Md., Application for Consent to Establish a Branch* (F.D.I.C. Feb. 9, 1981).

3. *In re: Citizens Bank & Trust Co. of Md., Riverdale, Prince Georges County, Md., Application for Consent to Merge & Establish Five Branches* (F.D.I.C. Feb. 9, 1981), reprinted in F.D.I.C. 1981 ANN. REP., vol. 2, 1981 Merger Dec. 9 (1982).

4. F.D.I.C. Order *in re Dauphin* (Denial), *supra* note 94.

5. *In re: Provident Sav. Bank, Jersey City, Hudson County, N.J., Application to Establish a Branch (Denial)* (F.D.I.C. Sept. 29, 1980).

6. F.D.I.C. Order *in re Dauphin* (reconsideration), *supra* note 120 (copies of 1-6 on file at Pacific Law Journal).

The above documents will be hereinafter cited simply as "F.D.I.C. Order *in re*:" followed by the most distinctive word in the bank's name, along with the item number.

205. F.D.I.C. Order *in re: Greater New York*, *supra* note 204, no. 1; F.D.I.C. Order *in re: Provident*, *supra* note 204, no. 5; F.D.I.C. Order *in re: Dauphin* (Denial), *supra* note 94.

206. Citizens Bank & Trust submitted two separate applications, which were approved on the same date and subject to the same conditions. The applicant was required to redelineate

role,<sup>207</sup> at least one of the denials resulted from internal agency procedures without the prompting of a community group.<sup>208</sup>

F.D.I.C. "orders" (rulings on bank applications) provide excellent examples of rigorous standards and effective "encouragement" of banks to more adequately help meet the credit needs of all parts of their communities. For example, Dauphin Bank in Harrisburg, Pennsylvania, had established a pattern and reputation of lending in suburbs of Harrisburg, while ignoring the inner city.<sup>209</sup> The bank made minor changes after a community group filed objections to its application, but was unable to demonstrate tangible improvement in serving the credit needs of inner-city areas. The application was denied.<sup>210</sup> Subsequently, Dauphin Bank directed widely-publicized efforts to inner-city neighborhoods to encourage loan applications, committed funds for real estate loans in lower-income neighborhoods, agreed to participate in the city's rehabilitation programs, and reached a written agreement with the community group that had originally protested the application. Less than a year after the original application, the bank won reconsideration and approval of its application.<sup>211</sup> Other decisions suggest that commitments and preliminary efforts to improve C.R.A. performance are considered favorably, but that significant demonstrated results are necessary for approval.<sup>212</sup> In support of this position, it may be noted that C.R.A. directs the supervisory agencies to consider the bank's record, not its promises.

Lending policies of a bank that are facially neutral but discriminatory in effect are unacceptable to the F.D.I.C. For example, the

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its community so as not to exclude low- and moderate-income neighborhoods, identify those neighborhoods and communicate with their residents, and establish a loan counseling program. F.D.I.C. Order in re: *Citizens* (Branch), *supra* note 204, no. 2; F.D.I.C. Order in re: *Citizens* (Merger), *supra* note 204, no. 3.

207. During 1979, 25 challenges were filed on C.R.A. grounds. F.D.I.C. 1979 ANN. REP. 20.

208. F.D.I.C. Order in re: *Provident*, *supra* note 204, no. 5.

209. F.D.I.C. Order in re: *Dauphin* (Denial), *supra* note 94.

210. *Id.*

211. F.D.I.C. Order in re: *Dauphin* (Reconsideration), *supra* note 120.

212. See, e.g., F.D.I.C. Order in re: *Greater New York*, *supra* note 204, no. 1. The bank had begun a program of advertising, contacting real estate brokers, and meeting with community groups, and it purchased municipal housing development corporation bonds. Its increase in local lending activity in Brooklyn was significant, but the absolute level was still very low. The F.D.I.C. Board of Directors found the banks progress to be "encouraging" but not "sufficiently favorable," and denied the application. The Comptroller of the Currency, in his capacity as one of the three F.D.I.C. Directors, dissented, arguing that the application should have been approved with the understanding that additional progress would be expected in the future. *Id.* at 2. One commentator found the majority decision (commending the progress but finding it insufficient) to be "somewhat enigmatic." Healey, *supra* note 58, at 734.



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Provident Savings Bank in New Jersey restricted itself to loans on recently-constructed one- and two-family residences<sup>213</sup>—a policy that is not invidious on its face. The effect, however, was a disproportionately high rate of rejection on loan applications from low- and middle-income neighborhoods, because a large proportion of the housing stock in those neighborhoods was older and multiple-family. Minority group applicants also suffered a disproportionately high rate of rejection. In addition, the bank's delineation of its community unreasonably excluded low- and middle-income neighborhoods, and the bank failed to maintain racial and other data required by regulation. Intentional discrimination by the bank was not conclusively established, but the bank's application was nevertheless denied.<sup>214</sup>

F.D.I.C.'s most recent denial or conditional approval of a bank application was in 1981, and the agency's C.R.A. enforcement program since then is difficult to assess. The program may have been impeded somewhat by financial difficulties of some of the banks supervised by F.D.I.C. in recent years.<sup>215</sup> It is quite likely that banks noted the agency's decisive treatment of bank applications involving C.R.A. issues in the years shortly after the Act's enactment, and adjusted their conduct accordingly.<sup>216</sup> However, insufficient data from F.D.I.C. is available to adequately gauge its current C.R.A. enforcement program.

#### D. Federal Reserve Board

The Board of Governors of the Federal Reserve System (F.R.B.) has a public record on C.R.A. enforcement that is noticeably divergent from the three other federal supervisory agencies. Although the F.R.B. joined in the uniform C.R.A. regulations, its public statements and formal rulings<sup>217</sup> indicate an interpretation and application of

213. F.D.I.C. Order in re: *Provident*, *supra* note 204, no. 5.

214. *Id.* Another example of "effects test" analysis is in F.D.I.C. Order in re: *Dauphin* (Denial), *supra* note 94.

215. In 1982, failures of banks with F.D.I.C. insurance totaled 42 (the highest number since 1940), as compared to 10 per year in 1978 and 1980. F.D.I.C. 1981 ANN. REP.

216. A member of F.D.I.C.'s staff describes C.R.A. as a "living success," causing banks and community groups to become more sophisticated regarding each other's concerns, to negotiate, and to reach accommodations. She states that no C.R.A. protests have been received by F.D.I.C. since 1982. Telephone conversation with Patricia A. McCormick, Office of Consumer Programs, F.D.I.C., Washington, D.C. (July 2, 1985).

217. The Board of Governors has given formal consideration to at least 28 bank applications protested on C.R.A. grounds, as follows (in chronological order):

1. Commerce Bancshares, 64 Fed. Res. Bull. 576 (1978), *aff'd per curiam sub nom. Manchester-Tower Grove Community Org./ACORN v. Board of Governors*, 607 F.2d 494



the rules that is markedly less stringent than the other agencies.

The F.R.B. resistance to C.R.A. appears based on ideological grounds, despite the fact that Congress has already weighed the competing policy considerations. The F.R.B. appears to remain unpersuaded that redlining exists or, if it exists, that it is a problem that should be addressed.<sup>218</sup> Although all four supervisory agencies

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(D.C. Cir. 1979).

2. Citicorp, 65 Fed. Res. Bull. 507, 512 (1979).
3. Ohio Citizens Trust Co. (decided May 1, 1979, per Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 819 (1981), but not otherwise reported in the *Federal Reserve Bulletin*).
4. Trust Co., 65 Fed. Res. Bull. 668 (1979).
5. Michigan Nat'l Corp., 66 Fed. Res. Bull. 247 (1980).
6. AmeriTrust Corp., 66 Fed. Res. Bull. 238 (1980).
7. Landmark Bancshares Corp. (decided Nov. 30, 1979, per Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 820 (1981), but not otherwise reported in the *Federal Reserve Bulletin*).
8. Mid-Continent Bancshares, Inc. (decided Nov. 9, 1979, per Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 820-21 (1981), but not otherwise reported in the *Federal Reserve Bulletin*).
9. First Nat'l Boston Corp., 66 Fed. Res. Bull. 162 (1980).
10. Manufacturers Hanover Trust Co., 66 Fed. Res. Bull. 601 (1980).
11. Society Nat'l Corp., 66 Fed. Res. Bull. 351 (1980).
12. Farmers & Merchants State Bank of Sebawaing (decided Dec. 4, 1979, per Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 821-22 (1981), but not otherwise reported in the *Federal Reserve Bulletin*).
13. Chemical Bank, 66 Fed. Res. Bull. 776 (1980).
14. F & M Bancshares, Inc., 66 Fed. Res. Bull. 508 (1980).
15. National City Corp., 67 Fed. Res. Bull. 52 (1981).
16. First Nat'l Boston Corp., 67 Fed. Res. Bull. 253, 576 (1981).
17. Girard Co., 67 Fed. Res. Bull. 916 (1981).
18. First Nat'l Bank of Allentown (decided Aug. 28, 1981, per Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 823 (1981), but not otherwise reported in the *Federal Reserve Bulletin*).
19. Midland Bank Ltd., 67 Fed. Res. Bull. 729 (1981).
20. AmeriTrust Corp., 68 Fed. Res. Bull. 65 (1982).
21. First Nat'l BanCorp. (application filed Aug. 27, 1981, listed as pending in Nov. 1981 in Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 823 (1981), but not otherwise reported in the *Federal Reserve Bulletin*).
22. NBD Bancorp., 68 Fed. Res. Bull. 306 (1982).
23. National City Corp., 68 Fed. Res. Bull. 427 (1982).
24. Citicorp, 68 Fed. Res. Bull. 499 (1982).
25. Mellon Nat'l Corp., 69 Fed. Res. Bull. 721 (1983).
26. Citicorp, 70 Fed. Res. Bull. 149 (1984) (acquisition of a Chicago thrift institution).
27. Bank of New England Corp., 70 Fed. Res. Bull. 374 (1984).
28. Citicorp, 70 Fed. Res. Bull. 431 (1984) (acquisition of a Maryland bank).

The above orders will be hereinafter cited merely by the most distinctive word(s) of the bank name, plus the year of decision where necessary for identification, along with the item number.

218. The attitude was stated in the first order discussing C.R.A. issues: "Other agencies of government may have primary enforcement responsibilities with respect to such matters as discriminatory lending practices, and . . . there are constraints upon the extent to which such laws as the Bank Holding Company and Bank Merger Acts should appropriately be used to

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agree that C.R.A. was not intended to impose mandatory government allocation of credit, the F.R.B. at times appears fixated on the issue, continuously reiterating its resolve not to participate in or countenance any form of credit allocation.<sup>219</sup> Even when a bank is willing, after negotiations with protesting community groups, to commit to improve credit availability in underserved areas, the F.R.B. is careful to dissociate itself from any provisions that might be deemed credit allocation.<sup>220</sup> In general, the Federal Reserve System has developed a reputation as, at best, disinterested in antidiscrimination and other social policy programs.<sup>221</sup>

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achieve favored social objectives." *Commerce Bancshares*, *supra* note 217, no. 1, at 893. See also several reports in Federal Reserve publications. Bowsher, *supra* note 23, at 3, 6. ("The success of community groups in convincing the press and public that lenders were not serving older urban areas was primarily the result of skillful publicity rather than substantial confirming evidence."); Canner, *Redlining: Research and Federal Legislative Response*, 68 Fed. Res. Bull. 610 (1982) (reporting empirical studies of "alleged redlining activities," and conceding "wide disparities" in lending in different neighborhoods, but stating that there is "little evidence to indicate that any neighborhood has been simultaneously redlined by all bankers"); T. BUYNACK, *supra* note 58.

219. Orders deciding protested applications consistently reiterate the position that credit allocation, including commitment by a bank of specified amounts or proportions of funds for a particular purpose, are not within C.R.A.'s mandate. See, e.g., *Commerce Bancshares*, *supra* note 217, no. 1; *AmeriTrust* (1980), *supra* note 217, no. 6; *Michigan Nat'l Corp.*, *supra* note 217, no. 5; *Manufacturers Hanover Trust Co.*, *supra* note 217, no. 10; *Landmark Bancshares*, *supra* note 217, no. 7; *First Nat'l Boston*, *supra* note 217, no. 9; *NBD Bancorp*, *supra* note 217, no. 22, at 308 n.4. See also Fed. Res. Sys., Community Reinvestment Act Information Statement, 45 Fed. Reg. 1940 (1980), reprinted in 66 Fed. Res. Bull. 30 (1980); *Hearings on S. 406*, *supra* note 2, at 14-15 (letter from Arthur Burns, Chairman of the Board of Governors) (Mar. 21, 1977); Canner, *Redlining: Research and Federal Legislative Response*, 68 Fed. Res. Bull. 610 (1982); Fed. Res. Bank of St. Louis, *News Release* (Nov. 30, 1979), cited in Canner, *The Community Reinvestment Act: A Second Progress Report*, 67 Fed. Res. Bull. 813, 820 (1981) [hereinafter cited as Canner, *Second*]; Fed. Res. Bank of Philadelphia, *News Release* (Aug. 28, 1981), cited in Canner, *Second*, *supra* at 823. The F.R.B.'s staff demonstrates a similar hostility to the concept of credit allocation. See, e.g., T. BUYNACK, *supra* note 58; G. CANNER, CREDIT ALLOCATION, *supra* note 119. See also Garwood, *supra* note 66, at 1308 ("The outcry against these rules is over real substance—the statute's perceived flirtation with the concept of credit allocation").

220. See, e.g., *Landmark Bancshares*, *supra* note 217, no. 7. Under the terms of a negotiated settlement, the protestant community group withdrew its protest, and the bank agreed to a specific dollar target for residential mortgage loans in the group's community. The F.R.B. approved the bank's application but issued a press release stating that "the Reserve Bank does not endorse any term of the agreement" that may result in credit allocation. G. CANNER, CREDIT ALLOCATION, *supra* note 119, at 5 (citing Fed. Res. Bank of St. Louis, *News Release* (Nov. 30, 1979)). A general statement of the Board's policy is in G. CANNER, REDLINING: RESEARCH AND FEDERAL LEGISLATIVE RESPONSE 610, 611 (1982).

221. See, e.g., Searing, *supra* note 39, at 1127-43 (of the four agencies, F.R.B. is the most dilatory and reluctant to enforce antidiscrimination laws); Note, *Legislating Against Mortgage Redlining: The Need for a Firmer Commitment*, 12 RUTGERS L.J. 151, 179 (1980). The F.R.B. has identified very few instances of violations of the 1968 Fair Housing Act or the Equal Credit Opportunity Act, either because discrimination does not exist or because no one has been looking for it. W. DENNIS, THE DETECTION AND CORRECTION OF CREDIT DISCRIMINATION: A REPORT TO THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM 141-42 (1978). In

When C.R.A. was enacted, commentators expected that enforcement by the F.R.B. would be characterized by "leniency."<sup>222</sup> Resistance to change became apparent in the Board of Governor's first reference to C.R.A. in an order approving a bank application.<sup>223</sup> The F.R.B. announced that C.R.A. had not changed previous law or the Board's policies, because credit needs had always been included within the traditional "convenience and needs" standard applied to applications for bank branches and mergers.<sup>224</sup> The F.R.B. then granted unconditional approval of a protested merger application filed by a St. Louis bank.<sup>225</sup> The circumstances of the decision were so questionable that it evoked immediate protests from the primary sponsors of C.R.A. in both the House and Senate.<sup>226</sup> The chief Senate sponsor of the legislation wrote that the F.R.B. had "totally misinterpreted the affirmative obligations principle" of C.R.A., construing it instead as "requiring nothing more than the absence of overt discrimination."<sup>227</sup>

The F.R.B.'s consumer compliance examiners find few C.R.A.-related problems that they consider serious. The Federal Reserve

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comparison, the F.H.L.B.B. found no violations for eight years, and 2,800 violations in the year following institution of a revised training program. *Id.* In enforcing Equal Credit Opportunity provisions, the F.R.B. has been shown to be far more solicitous of the interests of financial institutions than the statutory rights of consumers. Comment, *The Federal Reserve and the Equal Credit Opportunity Act: A Marriage of Inconvenience*, 2 ANN. BANKING L. REV. 301, 307-09 (1983).

222. Healey, *supra* note 58, at 729. The conclusion was based on a statement by the F.R.B.'s general counsel and also on "the traditional economic focus of the 'convenience and needs' test for deciding applications, and the F.R.B.'s policy of imposing the burden of proof on parties protesting a bank's application." *Id.* at 728-29.

223. *Commerce Bancshares*, *supra* note 217, no. 1.

224. *Id.* At the time of the order, C.R.A. had been enacted but was not yet effective. The Board stated that its decision would have been the same even if C.R.A. had been in effect. *Id.* at 579. Because the facts in the case were such that the Board could easily have justified its approval of the application on a finding that C.R.A. was not in fact violated, its deliberate effort to dismiss C.R.A. as merely repeating prior law has been construed as "sending a message to the industry, and perhaps to Congress, that the CRA would have no special impact on its evaluation philosophy." McCluskey, *supra* note 31, at 47 (1983). See also *Michigan Nat'l Corp.*, 66 Fed. Res. Bull. 247, 248-49 (1980).

225. *Commerce Bancshares*, *supra* note 217, no. 1.

226. Letter from Senator Proxmire, to Federal Reserve Board Chairman G. William Miller (Aug. 14, 1978), cited in R. BRANDEL & M. LARGE, *supra* note 29, at 26-27; Letter from Representative St. Germain, to Federal Reserve Board Chairman G. William Miller (Aug. 15, 1978), cited in R. BRANDEL & M. LARGE, *supra* note 29, at 27.

227. Senator Proxmire's letter stated that C.R.A. called for "aggressive and affirmative lending efforts to provide housing and small business loans in the local community, with particular emphasis on low and moderate income neighborhoods," but that the F.R.B. construed it as "requiring nothing more than the absence of overt discrimination." Letter from Senator Proxmire, to Federal Reserve Board Chairman G. William Miller (Aug. 14, 1978), cited in R. BRANDEL & M. LARGE, *supra* note 29, at 27.

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System uses the same numerical scale as the other four supervisory agencies for rating C.R.A. performance by individual depository institutions, with one being the best performance and five being the worst. As applied by the Federal Reserve, however, virtually no bank receives a five and only six percent receive a four or three.<sup>228</sup> The examiners' ability to identify C.R.A. violations is impaired by the fact the Federal Reserve System is alone among the four supervisory agencies in failing to develop a computer-assisted monitoring system.<sup>229</sup> The Federal Reserve System is also alone in failing to require registers of loan applications.<sup>230</sup>

Thousands of bank applications for branches or mergers have been considered,<sup>231</sup> including more than twenty-five that were protested on C.R.A. grounds that were deemed "substantive" by the F.R.B.<sup>232</sup> The total number of applications denied because of unsatisfactory C.R.A. records is zero. The total number of applications approved subject to a "condition" is one. The Board of Governors does not believe that poor C.R.A. performance should inhibit a bank's ability to expand. In the rare instances in which the Board of Governors does recognize a problem (occasionally even without the prompting of a community group protest),<sup>233</sup> the most stringent sanction is

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228. In 1982, no bank had a C.R.A. rating of five, and approximately six percent had ratings of three or four. Discussion, *supra* note 158, at 10 (statement of Mr. Baebel, Senior Review Examiner, F.R.B. Division of Consumer and Community Affairs). The official report for 1982 supplies additional detail, the usefulness of which is impaired by the fact that the percentages add up to 105%. "About 79 percent of the state member banks received a rating of 2; 12 percent, a rating of 1; 13 percent a rating of 3; and less than 1 percent, a rating of 4. No bank received a 5." BD. GOV. FED. RES. SYS., 69TH ANN. REP. 159 (1983). In 1984, the Federal Reserve Board rejected a recommendation of its Consumer Advisory Council to revise its C.R.A. rating system. *Announcement: Enforcement of Community Reinvestment Act*, 70 Fed. Res. Bull. 108 n.2 (1984).

229. SECTION 340(e) REPORT, *supra* note 148. The Federal Reserve Board in 1984 responded to a proposal of its Consumer Advisory Council to adopt an automated or computerized system for analyzing racial and other data on loan applicants by stating that the issue was "[l]eft open for future consideration." *Announcement: Enforcement of Community Reinvestment Act*, 70 Fed. Res. Bull. 108 (1984).

230. See *supra* note 148; *infra* text accompanying notes 249-51. The F.R.B. recently responded to a recommendation of its Consumer Advisory Council for development of a system for gathering information on race, national origin, sex, marital status, and age of loan applicants, by calling for further study. *Announcement: Enforcement of Community Reinvestment Act*, 70 Fed. Res. Bull. 108 (1984).

231. In 1982, for example, the Federal Reserve handled 1,596 bank applications covered by C.R.A. CON. ADV. COUN., THE FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63.

232. G. CANNER, CREDIT ALLOCATION, *supra* note 119, at 3 n.13. This study found 20 protested applications. Canner's study, prepared in 1982, should be updated by the four additional decisions in 1983 and 1984, listed as items 25 to 28 in *supra* note 217.

233. At least 26 nonprotested applications were reviewed from banks with a C.R.A. rating

recitation of "commitments" that the bank chooses to make (rather than "conditions" that are imposed by the F.R.B.) in the order approving the application.<sup>234</sup> Ten orders have referred to commitments<sup>235</sup> which usually relate to bank efforts to improve marketing and communication with the underserved areas of the community, and to training bank personnel to be aware of C.R.A. responsibilities.<sup>236</sup>

A few banks committed themselves to substantial changes in lending policies.<sup>237</sup> For example, one bank located in an urban area in which most residences were three- and four-family dwellings agreed to discontinue its policy against granting mortgage loans on that type of structure, and agreed to participate in housing rehabilitation projects.<sup>238</sup> When any bank policy might be interpreted as an allocation of credit created by circumstances other than market forces, however, the Board of Governors carefully designates that the policy is not a commitment to the Board.<sup>239</sup>

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that was less than satisfactory. All were approved, but with commitments or substantive changes to improve C.R.A. performance. Canner, *Second*, *supra* note 219, at 816. However, the details of these cases are not publicly disclosed.

234. As explained by a staff member of the F.R.B., "[t]he distinction between commitments and conditions hinges primarily on the fact that without a condition, an application otherwise would be denied." T. BUYNAK, *supra* note 58, at 4 n.2. The distinction is illustrated by a decision in which the F.R.B. accepted a "commitment" regarding C.R.A. factors and simultaneously imposed a "condition" regarding business practices in competition with other financial institutions. *Citicorp* (1984) (acquisition of Illinois thrift institution), *supra* note 217, no. 28. Reliance on "commitments" has been adopted as a general matter of policy. Information Statement re Community Reinvestment Act, 45 Fed. Reg. 1940 (1980), *reprinted* in 66 Fed. Res. Bull. 30, 31 (1980). "Commitments for future action" may outweigh "adverse aspects in a C.R.A. record." *Id.* Notably, when the other supervisory agencies issued a joint "Information Statement" plainly modeled on the F.R.B.'s earlier statement, the reference to promises outweighing actual performance was deleted. F.F.I.E.C., C.R.A. Information Statement, *supra* note 36; McCluskey, *supra* note 31, at 45.

235. Statement of Governor Teeters, in Discussion, *supra* note 158, at 1. Summaries of the first 21 cases are in Canner, *Second*, *supra* note 219, at 819-23.

236. For examples of Commitments, see *National City Corp.* (1981), *supra* note 217, no. 26; *Ameritrust*, *supra* note 217, no. 6; *Michigan Nat'l Corp.*, *supra* note 217, no. 5; *Ohio Citizens Trust Co.*, *supra* note 217, no. 3; *Mid-Continent Bancshares, Inc.*, *supra* note 217, no. 8; *Society Corp.*, *supra* note 217, no. 11; *Bank of New England*, *supra* note 217, no. 27. The banks committed themselves to increased advertising, attendance at meetings of community groups, contacts with local realtors, and designation of a bank officer to meet with the groups. One bank, upon acquiring a thrift institution, committed itself to maintain at least the same percentage of assets invested in local residential mortgages as the thrift had previously, and to "develop community programs." *Citicorp* (1984) (acquisition of Illinois thrift institution), *supra* note 217, no. 26.

237. See, e.g., *Landmark Bancshares Corp.*, *supra* note 217, no. 7 (bank agreed to offer certain types of F.H.A. loans at a one-half percent discount, and to reserve \$1 million for real estate loans in 1980).

238. *Society Nat'l Corp.*, *supra* note 217, no. 11.

239. G. CANNER, CREDIT ALLOCATION, *supra* note 119, at 5. As Governor Teeters has



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An examination of the particular facts underlying decisions to approve bank applications provides some insight into the Board of Governors' attitudes and standards. In a number of instances, the decision reached appears plainly incongruent with the seriousness of the violations and problems recited in the Board of Governors' orders. Worthy of particular attention are the decisions on applications filed by two banks: AmeriTrust Corporation of Cleveland,<sup>240</sup> and Michigan National Corporation of Bloomfield Hills, Michigan.<sup>241</sup>

In the 1980 *AmeriTrust* case, data prepared by the bank indicated that mortgage lending volume was eighteen times greater in high-income neighborhoods than in low- and moderate-income neighborhoods. Lower demand for credit in the less-wealthy areas accounted for much of the disparity, but far from all of it. According to the Board of Governors, even after adjusting for differences in credit demand, AmeriTrust was 1.6 times as active in providing mortgage loans in higher-income areas as compared to less-wealthy areas, and twice as active in suburbs as compared to the city. Perhaps most disturbing was the F.R.B.'s determination that AmeriTrust was twice as active in largely white areas as compared to largely black areas having similar income characteristics.<sup>242</sup>

Moreover, the bank engaged in practices masking the extent of discrimination in lending. According to the Board of Governors, AmeriTrust prescreened and discouraged loan applications in branch offices located in low- and moderate-income neighborhoods, in clear violation of federal rules, and failed to record other information necessary to monitor discrimination. The Board asserted that it viewed these violations as "extremely serious."<sup>243</sup>

AmeriTrust's attempts to determine the credit needs of lower-income areas in its community were ineffective, according to the

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stated, the Board of Governors has "resisted strongly any settlement of a C.R.A. protest that contains a commitment as part of the approval of a bank holding company application that requires the applicant to provide funds for a specific purpose. We feel that is an inappropriate use of regulatory powers." An example of a formal dissociation of the F.R.B. from an agreement between a community group and a bank, that might be construed as an allocation of credit, is in Fed. Res. Bank of St. Louis, *News Release* (Nov. 30, 1979), cited in Canner, *Second, supra* note 219, at 820. In contrast, the F.H.L.B.B. has no hesitation in specifying necessary changes in loan policy by a savings and loan association. See *supra* notes 179-85 and accompanying text.

240. *AmeriTrust* (1980), *supra* note 207, no. 6; *AmeriTrust* (1982), *supra* note 217, no. 20.

241. *Michigan Nat'l Corp.*, *supra* note 217, no. 5.

242. *AmeriTrust* (1980), *supra* note 217, no. 6, at 240.

243. *Id.* at 241.



Board of Governors, and the bank's advertising in black-oriented media focused on attracting deposits, not offering credit.<sup>244</sup> Relations with community groups were so abysmal that AmeriTrust refused to respond directly to their allegations, and the F.R.B.'s staff was unable to arrange a meeting format to which both sides would agree.<sup>245</sup>

In summary, the Board of Governors determined that AmeriTrust followed an lending policy having discriminatory effects, violated antidiscrimination regulations, and directed minimal efforts towards determining the credit needs of its entire community. Balanced against these extremely negative findings are certain, though rather limited, favorable aspects. The bank offered federally insured loans to small businesses, and participated in three federally insured housing projects (but had since discontinued making F.H.A. and V.A. loans). In home improvement lending, AmeriTrust was "somewhat more active" in black as compared to white areas (but nevertheless had only nineteen percent of its loans in low- and moderate-income areas); AmeriTrust supported some community groups (but two-thirds were outside of the city); and the bank held some government bonds (but none related to housing).<sup>246</sup>

Considering the relative weight of the negative and the positive aspects of the record, the determination by the Board of Governors is startling: "AmeriTrust has taken few steps aimed specifically to help meet the credit needs of low and moderate income areas, but while its record leaves room for improvement it would, absent other conditions, be consistent with approval of these applications."<sup>247</sup> As if in anticipation of litigation, the F.R.B. noted that it was permitted wide discretion, and that AmeriTrust had made certain "commitments," mainly to improve staff training. The F.R.B. also stated that it had considered the benefits of allowing "expansion of well managed financial institutions."<sup>248</sup>

The Board of Governors did, however, impose a "condition"—to date the F.R.B.'s most draconian publicly disclosed sanction against

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244. *Id.* at 240-41.

245. *Id.* at 239.

246. *Id.* at 240-41.

247. *Id.* at 241.

248. *Id.* at 241 n.6. The commitments were to (1) improve staff training, (2) offer either credit counselling or referrals to other organizations, (3) make public its real estate appraisal standards, (4) "study the feasibility of making public its lending policies," and (5) make public the commitments numbered (2), (3), and (4). In the litigation that followed, the F.R.B.'s decision was affirmed *per curiam*. *Manchester-Tower Grove Community Org./ACORN v. Board of Governors*, 607 F.2d 494 (D.C. Cir. 1979).

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a member bank based on C.R.A. AmeriTrust was required to maintain, for at least one year, a register of all inquiries and applications for real estate loans made in person.<sup>249</sup> Even this minimal requirement was considered too harsh by two of the Governors, who argued for approval without this "unwarranted burden."<sup>250</sup> In comparison, the F.D.I.C. and F.H.L.B.B. require loan inquiry registers as a matter of routine, even without a specific finding of "very serious" Equal Credit Opportunity violations.<sup>251</sup>

The community group that had led the challenge to AmeriTrust's application concluded that C.R.A. does not work, and that the Board of Governors was concerned that enforcement would induce banks to leave the Federal Reserve System. Their only solace was that approval of the application had been delayed by at least a year, at great cost to the bank and minimal cost to the group.<sup>252</sup> Two years later, in 1982, community groups filed a challenge to another AmeriTrust application, charging that the bank had failed to adhere to its commitments and conditions. That application was also approved, with yet another "commitment."<sup>253</sup>

A comparable decision was issued in the case of *Michigan National Corp.*, which sought approval for acquisition of four banks.<sup>254</sup> The order of the Board of Governors reported a series of extremely serious negative findings, a few minor countervailing factors, and the decision that the overall record justified approval of the application.

The order noted persistent violations of the basic procedural requirements of both H.M.D.A. and C.R.A., and intoned that the "Board views this noncompliance as a serious matter."<sup>255</sup> The bank granted only 7 mortgage loans per 100,000 units of housing located in low- and moderate-income areas, as compared to 101 such loans per 100,000 units in the remainder of the metropolitan area. More housing loans were made in white neighborhoods than in racially mixed neighborhoods with similar income levels. The bank failed to

249. *Ameritrust* (1980), *supra* note 217, no. 6, at 242.

250. *Id.* (concurring statement of Governors Wallich and Caldwell).

251. 12 C.F.R. §§ 338.4 (1986) (F.D.I.C.), 528.6 (1986) (F.H.L.B.B.).

252. V. BENEDEK, *supra* note 37, at 36-38.

253. *AmeriTrust* (1982), *supra* note 217, no. 20. For a view that AmeriTrust several years later has reformed, see *infra* note 268.

254. *Michigan Nat'l Corp.*, *supra* note 217, no. 5.

255. *Id.* at 248. The protesting community group experienced "considerable difficulty" obtaining the basic C.R.A. and H.M.D.A. data that by regulation should be freely available, according to the Board's order, and notices were not posted as required. *Id.*

systematically determine its community's credit needs, failed to market its credit services in low- and moderate-income neighborhoods, and oriented its advertising in those neighborhoods to deposits rather than loans. The only favorable factors were that the bank participated in some S.B.A., F.H.A., and Neighborhood Housing Services programs, and owned some securities issued by a state housing development authority. The Board of Governors approved the application, while extracting only "commitments" by the bank.<sup>256</sup>

Considering not only these two examples but all of the orders published to date, certain patterns become apparent. The orders mention C.R.A. issues only when a community group protests an application (with one possible exception).<sup>257</sup> A heavy burden of proof is imposed on protestants, who are taken seriously only if they provide extensive and sophisticated documentation.<sup>258</sup> Requests of protestants for a formal public hearing are consistently denied, with a remark in each case that no statute compels the agency to grant such hearings.<sup>259</sup> Violations of C.R.A. and H.M.D.A. procedural require-

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256. *Id.* at 248-49. The Bank agreed to designate bank personnel to meet with the public, to train its staff, to participate in additional (unspecified) special lending programs, and to increase credit marketing efforts in low and moderate-income areas.

257. Hutsonville Bank Corp., 67 Fed. Res. Bull. 48 (1981). The order did not mention any protestant but did note that "all comments received" had been considered. The applicant, which as the only depository institution in town, had discontinued making residential mortgage loans, and had a growing but very low ratio of loans to deposits. The application was approved.

258. Commentators have identified "a policy on the part of the Federal Reserve Board, not fully shared by the other bank agencies, of expecting community groups to undertake the bulk of analysis and carry the burden of proof." W. DENNIS & J. POTTINGER, *supra* note 5, at 10-22. This perception is amply supported by many of the Board's orders on protested applications. The actual conduct of the Board is in contrast with its public statements to Congress, which concede that C.R.A. shifted responsibility for determining whether banks are meeting community credit needs from the public to the regulatory agencies. Statement by Nancy H. Teeters, Member, Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, United States Senate (Feb. 19, 1980), 66 Fed. Res. Bull. 217 (1980); Statement by Gov. Rice to House Committee, 66 Fed. Res. Bull. 379 (1980).

259. See, e.g., *First Nat'l Boston*, *supra* note 217, no. 9, at 162 ("there are no material factual differences that would necessitate a hearing"); *National City* (1981), *supra* note 217, no. 15 (stating that the parties had ample opportunity for written submissions and that Federal Reserve staff had attended a meeting organized by Protestant); *National City* (1982), *supra* note 217, no. 15, at 428 (stating that no material facts were in dispute); *Chemical Bank*, *supra* note 217, no. 13 (no facts in dispute); *AmeriTrust*, *supra* note 217, no. 20, at 239; *Michigan Nat'l Corp.*, *supra* note 217, no. 5, at 249 n.10 (a hearing "would serve no useful purpose"); *Society Corp.*, *supra* note 217, no. 11, at 352 (hearing would serve no purpose). While denying requests for "hearings," however, the F.R.B. will occasionally arrange "public meetings," which are "intended to shorten the processing time" needed by the Board to rule on the application. Statement of Governor Teeters in Discussion, *supra* note 158, at 2. A total of three such "public meetings" have been held. CONS. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63, at 6.6. Private meetings are encouraged, because they

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ments are tolerated if the applicant either discontinues the violations or promises to do so.<sup>260</sup>

The Board of Governors has conceded, both as a general matter and in specific instances, that levels of credit are disproportionately low in lower-income neighborhoods, and that legitimate economic factors do not provide a full justification.<sup>261</sup> Yet when statistical evidence documents such a "disparity," the Board of Governors has been alert to any possibility, however remote or hypothetical, that a variety of market forces might be responsible. The F.R.B. readily accepts partial and unverified explanations, and states that evidence of actual discriminatory intent is not available.<sup>262</sup> When exhaustive

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allow more realistic opportunities for negotiation and compromise. Whether a public forum should be provided when private meetings fail is a matter of considerable controversy. One view is that community awareness and confidence in the system would be enhanced, and that polarization of the parties has already occurred. The contending position is that public confrontations are unfairly harmful to banks and impede resolution of differences, and that the availability of a public meeting could be used by community groups as a bargaining chip to extract concessions. *Id.* at 6.6, A.13.

260. See, e.g., *Michigan Nat'l Corp.*, *supra* note 217, no. 5; *Society Corp.*, *supra* note 217, no. 11; *First Nat'l Boston* (1981), *supra* note 217, no. 19. One commentator has concluded that

the Federal Reserve Board will look with favor on all indications that an institution intends to change a previously poor C.R.A. record, and, where such performance does improve, a poor previous record will not be held against an institution . . . . An applicant may "negotiate" with the Federal Reserve Board, moreover, if its CRA record to date is poor.

W. DENNIS & J. POTTINGER, *supra* note 5, at 10-20.

261. The Board states: "This is a serious matter." *Information Statement Re Community Reinvestment Act*, 66 Fed. Res. Bull. 30, 31 (1980); F.F.I.E.C., C.R.A. Information Statement, *supra* note 36, at 4.

262. In the *Society Corp.* Order, *supra* note 217, no. 11, at 353, the Board conceded the existence of a "significant disparity between the proportion of mortgage loan demand accommodated by [the bank] in suburban areas of Cuyahoga County and the demand accommodated in Cleveland." The Board, however, was content to speculate that this "disparity may be the result of a variety of other factors, such as the institutional structure of the market." No further explanation and no indication of Board investigation of the matter was included in the order.

Michigan National Bank granted 124 times as many loans in high-income areas as low- and moderate-income areas. The Board hypothesized that this pattern "may be partially the result of" a lower percentage of owner-occupied units in the lower-income areas. *Michigan Nat'l Corp.*, *supra* note 217, no. 5, at 249. In the *National City* case, "the disparity between the amount of funds committed by Applicant to housing-related credit in low- and moderate-income areas versus all other areas may be partially the result of factors that affect demand for such credit." *National City* (1981), *supra* note 217, no. 15, at 56. Ohio Citizens Trust granted comparatively few housing loans in certain areas, but the Board again accepted a partial explanation (based on low average household income and urban renewal in the areas). *Ohio Citizens*, *supra* note 217, no. 3. Citibank of New York closed proportionately more branch offices (and opened fewer new ones) in minority and low-income areas than in other areas, and the proportion of its mortgage lending in the disfavored areas declined. The F.R.B., however, chose to rely on the premise that mortgage lending was still possible in an area having no branch office. *Citicorp* (1984) (acquisition of New York bank), *supra* note 217,

documentation prepared by community groups demonstrates that a bank's lending patterns are racially discriminatory in effect, the F.R.B. has stated that no evidence of actual discrimination against individuals or of illegal credit practices was presented.<sup>263</sup> Even when such evidence is presented, the applications are approved.<sup>264</sup>

no. 2. See also *First Nat'l Boston Corp.*, *supra* note 217, no. 9 (bank had no residential mortgage loans in lowand moderate-income areas, but was changing its policies). According to one analyst, "the Board has hewn to a consistent line in downgrading credit-needs anaysis." McCluskey, *supra* note 31, at 48.

263. A recent order suggests that statistical analysis, no matter how extensive or sophisticated, will never be adequate to persuade the Board of Governors that discrimination exists. A community group protesting an application of National City Corporation of Cleveland, Ohio, applied multi-variate regression analysis to evaluate H.M.D.A. data, deed title transfer information, and census data. The study's results, which were not disputed by the bank, demonstrated that the bank extended less conventional mortgage credit in nonwhite neighborhoods than in white neighborhoods. Moreover, when the bank did lend in integrated and predominantly nonwhite areas, the borrowers were primarily white home-buyers. *National City*, *supra* note 217, no. 15, at 428-29. The Board of Governors' response was that multiple regression analysis does "not conclusively establish the significance of any particular variable," and that "apparently" the bank "receives relatively few mortgage loan applications from lower-income neighborhoods and neighborhoods with a predominantly minority population." *Id.* at 429, 429 n.7.

In another case, the bank's mortgage credit activity was shown to be nearly six times greater in predominantly white neighborhoods than in predominantly black neighborhoods. Furthermore, lending declined in direct proportion to increases in nonwhite population in a particular neighborhood. The Board of Governors response was that "Protestants have not provided affidavits from individuals who claim to have been discriminated against." *National City* (1981), *supra* note 217, no. 15, at 55. See also *Michigan Nat'l Corp.*, *supra* note 217, no. 5; *Society Nat'l Corp.*, *supra* note 217, no. 11; *NBD Bancorp.*, *supra* note 217, no. 22.

A study prepared for the F.R.B. found that "there are no cases involving credit discrimination against minorities in the entire Federal Reserve System." CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63, at 4.8. To some of the members of the investigating panel, the F.R.B.'s bank examiners appeared "somewhat apathetic about the fair lending exam." *Id.* at 4.9.

264. See, e.g., Canner, *Research and Federal Legislative Response*, 68 Fed. Res. Bull. 610 (1983) (conceding the existence of "wide disparities" in conventional lending in different neighborhoods, but intimating that the problem is not serious because there is "little evidence to indicate that any neighborhood has been simultaneously redlined by all lenders" (emphasis added)). See also the F.R.B.'s decisions in *Ameritrust*, *supra* note 217, no. 6; *Michigan Nat'l Corp.*, *supra* note 217, no. 5. In the *Ameritrust* case, protestants provided data showing that the bank was twice as active in largely white as in largely black areas with similar income characteristics, and specific evidence that three creditworthy individuals from black neighborhoods were denied credit. The Board of Governors found violations of Equal Credit Opportunity regulations, but no "pattern of discrimination." *Ameritrust* (1980), *supra* note 217, no. 6, at 241-42.

Two commentators have concluded that the "Federal Reserve Board's official attitude is that, generally speaking, there is no point in denying applications because of 'holes' in an institution's C.R.A. record. According to the Board's general counsel, the purpose of C.R.A. is to encourage improved lending records—not to hamper expansion." W. DENNIS & J. POTTINGER, *supra* note 5, at 10-20. Another study found that bank examiners in certain Federal Reserve Banks "expressed skepticism over whether supervisory action, rather than moral suasion, would be used even if they were able to find substantive violations by state member banks." CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63, at 4.8.



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The formal rulings by the Board of Governors are, of course, only one element of the Federal Reserve System's C.R.A. enforcement process, and not sufficient in themselves to justify a reliable generalization.<sup>265</sup> Still, the rulings collectively send a message to banks that are members of the System.<sup>266</sup> Not once has the performance of an applicant bank been found unsatisfactory. That fact, coupled with the public pronouncements of the F.R.B., other aspects of the F.R.B.'s enforcement program, and its overall reputation in civil rights and social issue regulation, must surely detract from the effectiveness of the F.R.B.'s compliance efforts.

Some positive results have been achieved,<sup>267</sup> and there are some indications of improvements in attitudes and policies.<sup>268</sup> Hardly any

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265. One means of attaining compliance without producing a record of applications denied would be to informally counsel banks with unsatisfactory C.R.A. performance to withdraw their applications until the banks' performance improve sufficiently—a policy that the F.H.L.B.B. has used with some effectiveness. The Federal Reserve System apparently follows a similar policy occasionally. See Bd. Gov. Res. Sys., 69TH ANN. REP. 159 (1983) (reporting that in 1982 one bank withdrew an application, to provide time for improvements in C.R.A. performance); W. DENNIS & J. POTTINGER, *supra* note 5, at 10-18. The critical difference between the F.H.L.B.B. and the F.R.B. in this regard, however, is that the F.H.L.B.B. has not established a record of granting formal unconditional approval to banks having extremely negative C.R.A. records.

266. As a Federal Reserve staff member wrote, the orders "were intended to communicate public policy stances with respect to CRA implementation." G. CANNER, CREDIT ALLOCATION, *supra* note 119, at 3.

267. In 1982, for example, one bank application was withdrawn to allow the bank time to improve its C.R.A. performance, and another was approved following an negotiated settlement between the bank and a protestant. Bd. Gov. Fed. Res. Sys., 69TH ANN. REP. 159 (1983). More than a dozen banks have made commitments to the F.R.B. in response to protest initiated by community groups. Canner, *Second, supra* note 219.

Although The Consumer Advisory Council of the Federal Reserve Board listed over 50 criticisms and suggestions for improvement of C.R.A. enforcement, it also found favorable aspects. According to the report, the F.R.B. staff's community outreach, its training of consumer compliance examiners, and its use of outside contacts in the examination process are "far greater and more extensive than that of both the Comptroller of the Currency and the Federal Deposit Insurance Corporation." CON. ADV. COUN., FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A., *supra* note 63, at 3.2. The Federal Reserve Board adopted many of the Council's recommendations, including improved public notice of bank applications, clarification of the functions of Community Affairs Officers in the regional Reserve Banks, increased emphasis on contacts with minority and community groups, and development of additional materials for use by compliance examiners. The F.R.B. decided against prompt action implementing systems for gathering or analyzing racial and other information on loan applicants, or routine use of "testers" for illegal credit discrimination. Announcement: Enforcement of Community Reinvestment Act, 70 Fed. Res. Bull. 108 (1984).

268. According to the F.R.B.'s Community Affairs Coordinator, C.R.A. implementation has been extremely successful, achieving slow but steady progress in changing attitudes and behavior of the Board of Governors, the Federal Reserve staff, and the regulated banks. Telephone conversation with James W. Lowell, Community Affairs Coordinator, Division of Consumer and Community Affairs, F.R.B., Washington, D.C. (July 3, 1985). Many billions of dollars have been invested in communities that would not have been invested before C.R.A., which caused banks to learn that local investment is good business. The reason that such



evidence of substantial reform, however, has yet become apparent in the F.R.B.'s publicly disclosed record.<sup>269</sup> At present, the Federal Reserve System appears to be the least committed and the least effective of the four supervisory agencies in C.R.A. enforcement.<sup>270</sup>

## VI. PROSPECTS FOR THE FUTURE: THE EFFECTS OF DEREGULATION

A superficial consideration of the current movement toward deregulation of the banking industry<sup>271</sup> might suggest that programs such as the C.R.A. are due for decline or repeal.<sup>272</sup> What is far more

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progress is not apparent in the public record, he stated, is that agreements are reached in private meetings of banks and community groups, and banks withdraw applications fairly often to avoid the publicity of denial. The F.R.B. monitors "commitments" carefully, and is prepared to deny an application if necessary. He stated also that *AmeriTrust* (discussed in *supra* text accompanying notes 240-53) maintained the required register of loan applications for three years, changed its management and policies, and is now a model of C.R.A. performance. *Id.*

269. Even the Consumer Advisory Council of the Federal Reserve Board, performing a study on implementation of C.R.A. at the Board's request, was denied information vital to evaluation of the F.R.B.'s staff's operating practices. According to the Council, "[e]xaminers' work papers were not made available . . ." "records of application protest proceedings excluded confidential trade information, staff recommendations and examination report information," and "a significant portion of staff analyses and recommendations were deleted . . ." CON. ADV. COUN., *FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A.*, *supra* note 63, at 2.1. Under such circumstances, it seems not unreasonable to evaluate the F.R.B. on the basis of the information it releases to the public, and to maintain a noncommittal attitude toward indications of reform that is not yet reflected in the public record.

270. See, e.g., McCluskey, *supra* note 31, at 46 (referring to the "disengagement of the FRB from her sister agencies over the use of CRA . . . as a regulatory tool" and the "dichotomy" between the FRB and the other agencies).

271. Depository institutions have been allowed to expand into new lines of business, such as stock brokerage and equity participation in real estate ventures. See, e.g., Statement by J. Charles Partee, Governor, Board of Governors of the Federal Reserve System, before the Subcommittee on Telecommunications, Consumer Protection, and Finance of the Committee on Energy and Commerce, United States House of Representatives (Apr. 2, 1985), 71 Fed. Res. Bull. 409, 411 (1985) [hereinafter cited as Statement of J. Charles Partee, Governor, F.R.B. (1985)]. At the same time, they have been subjected to unaccustomed competition in their traditional functions from, for example, "non-bank banks," companies that either accept deposits or offer loans, but not both, and thus escape the jurisdiction of the federal supervisory agencies. *Id.* at 410; Statement by Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, United States House of Representatives (Apr. 17, 1985), *reprinted in* 71 Fed. Res. Bull. 424 (1985) (referring to "evasion of some of the basic tenets of public policy . . ." by "non-bank banks" and noting also the potential for evasion by "non-thrift thrifts").

272. The F.R.B.'s Consumer Advisory Council reported in 1983 on comments it had received from many banks and community groups:

Federal responsibility for various social programs was increasingly being questioned, with federal budget deficits and administration policy supporting a shift of these programs to state and local governments. As one Council member aptly stated it, "CRA is trying to accomplish something which was a lot more popular a decade ago than it is now."

CON. ADV. COUN., *FEDERAL RESERVE'S IMPLEMENTATION OF C.R.A.*, *supra* note 63, at 3.2.

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likely, however, is that C.R.A. will be retained and its importance expanded.

Disenchantment with federal regulation of private enterprise, at a general or abstract level, does not extend to specific consumer protection regulations.<sup>273</sup> The deregulation of banking that has occurred in recent years has allowed increased competition among financial institutions and new combinations of financial services.<sup>274</sup> The restrictions that were removed protected, at least in the first instance, the banking industry rather than the public at large.<sup>275</sup> No significant change has been made to consumer protection regulations affecting financial institutions, such as those promulgated under the Equal Credit Opportunity,<sup>276</sup> Fair Credit Billing,<sup>277</sup> Home Mortgage Disclosure,<sup>278</sup> and Consumer Leasing Acts.<sup>279</sup> Public support for this class of regulations, which includes C.R.A., remains strong.<sup>280</sup>

C.R.A. has never been a bureaucratic program producing massive paperwork, detailed regulations, or compulsory changes in specific private decisions. By requiring only that banks actively seek profitable lending opportunities in their own communities, C.R.A. is fully compatible with current political orientations. The most appropriate government response to social problems, many believe, is to promote partnership and cooperation among business and the community—precisely C.R.A.'s approach.<sup>281</sup> Moreover, the practical necessity of

273. Garwood, *supra* note 66. Though expressing his personal views only, Mr. Garwood is Director, Division of Consumer and Community Affairs, Federal Reserve Board, and so in a position to have detailed knowledge of the extent and effects of changes in bank regulation.

274. *Id.* at 1298 (referring to such changes as removing restrictions on payment of interest on deposits, on the business that can provide financial services, and on the locations where financial services can be offered); see also Lobell, *supra* note 94.

275. Garwood, *supra* note 66.

276. Equal Credit Opportunity Act, 15 U.S.C. § 1691 (1982); Regulation B, 12 C.F.R. § 202 (1983).

277. Fair Credit Billing Act, 15 U.S.C. § 1666 (1982); Regulation Z, 12 C.F.R. § 226 (1983).

278. Home Mortgage Disclosure Act, 12 U.S.C. § 2801 (1982); Regulation C, 12 C.F.R. § 203 (1982).

279. Consumer Leasing Act, 15 U.S.C. § 1667 (1982); Regulation M, 15 C.F.R. § 113 (1983).

280. A Louis Harris poll found strong public antipathy to regulations that directly control pricing, but "virtually no support for rolling back or dismantling consumer protection regulation." LOUIS HARRIS & ASSOCS., INC., CONSUMERISM IN THE EIGHTIES, Study No. 822047 (1982), cited in Garwood, *supra* note 66, at 1299.

281. The Federal Reserve's Community Affairs Coordinator emphasizes the importance of sensitivity to political orientations. Telephone conversation with James W. Lowell, Division of Consumer and Community Affairs, F.R.B., Washington, D.C. (July 3, 1985). Promoting "compliance with C.R.A.," he says, is not useful or productive. On the other hand, excellent results have been achieved by promoting "community involvement," and "partnerships" among banks and others in the community. Both Democrats and Republicans are responsive to C.R.A.'s goals, when properly phrased and presented. *Id.*

relying on private depository institutions to assist in community development is increased as federal subsidies and programs for that purpose decline.<sup>282</sup>

The continuation of federal supervision over depository institutions also seems assured, though the form and structure of regulatory agencies may well change, to adapt to modern trends in the financial services industry. The need for government supervision of institutions that accept consumers' savings and other deposits has been firmly established ever since the Great Depression, and periodically reinforced by failures of the few depository institutions still unregulated or uninsured.<sup>283</sup>

The deregulation that has occurred to date has increased the rate of mergers, acquisitions, and expansion of financial institutions, and each of those transactions requires regulatory approval with consideration of C.R.A. issues. Community groups have often seized the opportunity to negotiate with the institutions for improvements in community lending practices.<sup>284</sup> From the point of view of the financial institution, the danger of denial of the necessary regulatory approval may be minimal,<sup>285</sup> but the danger of expensive delay and embarrassing publicity is great. The financial institutions are likely to go to substantial lengths to reach agreement with community

282. Ansberry, *supra* note 110, at 64, cols. 1-5. The views of Michael Shea, of the Association of Community Organizations for Reform Now (ACORN), which has been involved in C.R.A. protests around the country, are representative: "There's been tremendous cutbacks in federal housing money. We have to look elsewhere for financing." *Id.*

283. See, e.g., Statement of J. Charles Partee, Governor, F.R.B. (1985), *supra* note 271, at 410 ("the normal perception for most industries—that one may simply look to the marketplace to promote competition and efficiency—must be tempered by a recognition of the need to maintain confidence in banking institutions . . ."). Collapse of depository institutions can have serious consequences, as the 1985 crisis in several Ohio savings and loan associations (which were not federally insured) suggest. See, e.g., Statement by Preston Martin, Vice Chairman, Board of Governors of the Federal Reserve System, before the Subcommittee on Commerce, Consumer and Monetary Affairs of the Committee on Government Operations, United States House of Representatives, 71 Fed. Res. Bull. 412, 415 (1985) ("the events in Ohio do serve to remind us of the potential consequences of the loss of public confidence in individual depository institutions and of the celerity with which that loss can spread to other institutions.").

284. Garwood, *supra* note 66, at 1304, citing as one example the application of Citicorp to acquire a South Dakota bank, protested by two New York community groups because of Citicorp branch closings in New York City. See also Ansberry, *supra* note 110, at 64, cols. 1-5. "The CRA, however, has assumed even greater significance with the recent rise of interstate banking and the steady decline in federal funding for low-income housing." *Id.*

285. One commentator, involved with C.R.A. since its inception, has concluded that C.R.A., "with its balancing tests, countervailing interests, and multipronged analysis, rarely presents an obstacle to bank expansion in the 1980's." Dennis, *Coping With Branch Consolidations*, BANKERS MAG., Sept.-Oct. 1984, at 22, 25, cited in Note, *supra* note 22, at 132 n.160.

activists and thereby avoid the filing of a formal protest with the regulatory authorities.<sup>286</sup>

Changing modes of regulation by the supervisory agencies is probably less of a threat to the goals of C.R.A. than changing technology and economics in the financial services industry. For example, the increasing use of automatic teller machines, often as substitutes for branch offices, may escape C.R.A. review unless the regulations are modified.<sup>287</sup> Also, legislation may be needed to extend C.R.A.-type principles to certain nondepository financial services companies. These firms currently are not subject to regulation by the four federal supervisory agencies, and so are not covered by C.R.A., but are increasingly competing with the depository institutions that are subject to C.R.A.<sup>288</sup>

286. See, e.g., Ansberry, *supra* note 110, at 64, cols. 1-5. "Rather than risk costly delays, more and more banks, though defending their loan records to low-income borrowers, are negotiating community investment pacts with consumer activist groups." *Id.* (citing several recent examples). When the stakes are high enough, however, a bank may incur the protest and ultimately prevail before the regulatory agency. See, e.g., Applications of Dimension Fin. Corp. to Charter 31 Nat'l Banks in 25 States (Compt. Curr. May 9, 1984), cited and discussed in Lobell, *supra* note 94, at 1087, n.71 (application approved despite C.R.A. protest and bank's plan to "focus marketing efforts on upwardly mobile individuals").

287. The regulations currently list as one factor to be included in a C.R.A. evaluation "[t]he bank's record of opening and closing offices and providing services at offices." 12 C.F.R. § 25.7(g) (1986). However, closing an office and opening an automatic teller machine are not events triggering a C.R.A. evaluation. 12 U.S.C. § 2902(3)(a)-(f) (1982). Thus, a depository institution might be able to close its offices in low-income neighborhoods and open automatic tellers in high-income neighborhoods, thereby significantly altering the community impact of its services, without being subjected to C.R.A. review. This situation is one illustration of a more general observation that "new electronic technologies invites evasion of the present branching restrictions," and regulation must adapt to new banking techniques such as automatic tellers to avoid costly and irrational distortions in the banking system. Felsenfeld, *Electronic Banking and Its Effects on Interstate Branching Restrictions—An Analytic Approach*, 54 *FORDHAM L. REV.* 1019, 1021, 1059-61 (1986).

Another problem is that banks often avoid low-income neighborhoods as sites for automatic teller machines, consigning the residents to less convenient and more expensive banking services. *EFT in the United States: Policy Recommendations and the Public Interest—The Final Report of the National Commission of Electronic Funds Transfer, Part V: Automated Payment Systems*, BANKING L.J. DIG. v-55 (Cum. Fed. Supp. 6th ed. 1982). This pattern "constitutes a form of geographic disinvestment, in violation of the purpose of C.R.A." Note, *supra* note 22, at 133. This Syracuse Law Review Note thoroughly analyzes the problem and New York's solution under its regulations paralleling the federal C.R.A. Essentially, New York requires advance notice of branch office closings, N.Y. BANKING LAW § 28-(c)(2) (McKinney Supp. 1986), extends C.R.A. review to changes in use of automatic teller machines, N.Y. BANKING LAW §§ 105-a, 240-a, 396-a (McKinney Supp. 1986); N.Y. ADMIN. CODE tit. 3, § 73.1 (1985); and adds "[t]he geographic distribution and use of automatic teller machines" as a measure of serving community credit needs, N.Y. BANKING LAW § 28-b(3)(a)(11-a) (McKinney Supp. 1986). See Note, *supra* note 22, at 140-42.

288. The issue was raised, for example, by Michael Van Buskirk, vice president of BancOne Corp. based in Columbus, Ohio. He stated that subjecting full-service banks to C.R.A. review, while leaving limited-service competitors such as Sears, Roebuck & Co.'s financial centers

## CONCLUSION

From some perspectives, the results attributable to the C.R.A. after a full decade of operation are modest and largely unquantifiable. The number of bank requests for approval of proposed mergers, acquisitions, or office changes that have been denied on C.R.A. grounds is negligible. The record of some federal agencies, notably the Federal Reserve Board, suggests only the most grudging enforcement efforts. The total dollar volume of lending to low- and middle-income neighborhoods that is directly motivated by the need to comply with C.R.A. appears large but is difficult to verify,<sup>289</sup> despite the numerous anecdotal examples. The Act is so vague and abstract that compliance is difficult to define, much less enforce.

An historical and comparative perspective, however, yields a different conclusion. C.R.A. established a basic principle of bankers' responsibility, reversing and rebuking the views generally prevailing previously in the banking industry and the supervisory agencies. Financial institutions have unquestionably modified their lending policy to consciously attempt to better serve community credit needs.<sup>290</sup> Legal developments of that nature are not rendered unimportant by the fact that issues of implementation are left to be resolved later, or by the fact that the tangible results are difficult to accurately measure.

Using as an analogy a legal development of dramatically greater import, the Supreme Court's decision in *Brown v. Board of Education*<sup>291</sup> conclusively established for the first time that government-supported segregation was unacceptable. Litigation and controversy has continued since then, and the process has been painfully slow, but the issues in the debate are on an altogether different plane. The issues now are not whether integration is necessary but rather how much is enough and what methods are appropriate. C.R.A., though not remotely as significant as *Brown*, conclusively

untouched, was unfair. Michael Shea, of the Association of Community Organizations for Reform Now ("ACORN"), an activist organization which has been involved in C.R.A. protests around the country, agrees that firms such as Sears should be covered. "We're looking at those too," he said. "It's just a matter of time." Ansberry, *supra* note 110, at 64, cols. 1-5.

289. One estimate is that, since the enactment of C.R.A., "more than \$3.7 billion has been committed in 117 cities for home mortgage, small business and other loans to predominantly low-income borrowers." *Id.* The article did not cite a source for this estimate, however.

290. For examples, see sections III.B. and IV.B., *supra*, and sources cited therein.

291. 347 U.S. 483 (1953).



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established that depository institutions not only may legitimately lend with a view to improving community conditions, but indeed are obliged to attempt to do so.

The chief force for improvements in depository institutions' efforts to meet community credit needs has been the activism of community groups. C.R.A. has tended to bring the groups off of picket lines on the streets outside banks and savings and loan associations, and into the conference rooms. They now have standing and legitimacy that they did not have before C.R.A. Their power derives largely from the ability to cause delay in the processing of applications for regulatory approval of mergers, acquisitions, and office changes, if their objections are well-documented and cogently presented. Many have been extremely successful and will continue their efforts. The C.R.A. should be improved by establishing a private civil cause of action so that community groups may enforce the law when supervisory agencies decline to do so.

The banking officials and regulators who prior to 1977 resolutely and unapologetically denied that they had any responsibilities to serve the credit needs of local communities are now in the position of explaining how they are doing enough to fulfill those responsibilities. The C.R.A. has performed a valuable function. It deserves to be enforced with far greater vigor than has been demonstrated to date by the federal banking supervisory agencies.